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The general rule for the control of unfair terms in contracts : justifications and operational contents.

THE GENERAL RULE FOR THE CONTROL OF UNFAIR TERMS IN CONTRACTS: JUSTIFICATIONS AND OPERATIONAL CONTENTS

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ABSTRACT

This thesis attempts the concept of having a general rule authorising the courts to scrutinise terms in contracts in general by candidly declaring invalid such term as is found to be unfair. The main concern is with unfair clauses which are acceded to *even in the absence of traditional procedural improprieties in their formation process.*

Chapter 1 explores justifications for such a rule as well as delineate its appropriate contents. It demonstrates that the rule should not have the effect of allowing the courts to rectify unfair consequences caused without procedural improprieties. Focusing on market imperfections and regarding them as procedural flaws, this chapter concludes that judicial nullification of contractual terms can be justified on the ground of "ignorance" relating to either the existence or the implications of the terms contained in written contracts. This type of ignorance can be subdivided into three forms: ignorance of the existence of *inconspicuous terms*; ignorance of the existence of contract terms due to the *absence of opportunity to ascertain them*; and ignorance of the implications of *incomprehensible terms*. In none of these ignorance-based scenarios have contracting parties been sufficiently protected by traditional rules of contract law. New legislation is thus necessary. Various economic and contract theories are discussed in support of these conclusions.

Chapter 2 investigates English courts' attitudes towards the upholding of fairness in contractual terms. A division is made between the pre-mid-twentieth century position and mid-twentieth century onwards position in order to show the development influenced by economic concepts. The prime objective of this chapter is to point out that despite the courts' increasing anxiety about unfairness in the terms of private bargains to the extent of once attempting to formulate, in *Lloyds Bank* v. *Bundy*, the "general rule" primarily concerned with unjust terms, judge-made law remains insufficient as long as unfair terms caused by such forms of ignorance as above are still unremedied under common law. This deficiency entails legislative movements.

This will be followed by the critical examination, in Chapter 3, of the Unfair Contract Terms Act 1977 with a view to gaining insights into the appropriateness or inappropriateness of the legislative framework applied. Fuller insights will be obtained from Chapter 4 where the doctrine of "unconscionability" which is embodied in the U.C.C. § 2-302 of the United States is investigated. Chapter 5 will, next, thoroughly discuss the framework introduced by the EC Directive on Unfair Terms in Consumer Contracts. Shortcomings as are reflected in these legislative frameworks will provide an avenue for reform, the subject to be dealt with in the final and concluding chapter.

Chapter 6 works out sharp and appropriate criteria for assessing an unfair character of a contract term, in an endeavour to eliminate uncertainty and unpredictability which is most likely to arise from the courts' determination of fairness. It points out that although "absolute" certainty is impossible to be attained in the instance concerning fairness, some workable criteria for assessing an unfair substance of contract terms can be established to the extent where traders can foresee that a particular clause is *likely to be* denied enforcement. Amongst those indicia of fairness or unfairness proposed in this thesis are the "necessity for the protection of legitimate interests" and the "loss-avoidance position". The concluding chapter, Chapter 7, suggests that these criteria be inserted in the legislation when reform is conducted.

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I HEREBY DECLARE THAT THE WHOLE WORK CONTAINED IN THIS THESIS IS MY INDEPENDENT WORK AND THAT VIEWS EXPRESSED THEREIN ARE MY OWN AND NOT THE UNIVERSITY'S.

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CHAPTER 1

JUSTIFICATIONS FOR A GENERAL RULE FOR THE CONTROL OF UNFAIRNESS IN CONTRACT TERMS

I: INTRODUCTION

Over the past few decades, "fairness" in contracts has been the subject of increasing concern by lawyers. There are two types of fairness in contracts, viz (1) "*procedural fairness*" and (2) "*substantive fairness*". The first branch of this dichotomy ensures that a contract reached by the parties must be free from all sorts of impropriety during its bargaining or formation process and that a contract molded through any improper means (either by coercion, force, pressure, misrepresentation, deception, fraud or other unacceptable manners) exercised by one party during its bargaining process will be regarded as procedurally unfair[1]—for the consequence of the impropriety in question is the *vitiation* of the consent[2] of the other party who, despite his seemingly apparent consent to the contract, has never given his real consent. The other type of contractual fairness is not concerned with procedure but with the fairness of the substantive result of a contract. Under this premise, a contract without any defect in its bargaining process can also be unfair if there exists onerous non-equivalence or, to use Lord Brightman's language in *Hart* v. *O'Connor*[3], "*contractual imbalance*" in the values exchanged by contracting parties. Although the distinction has been made between procedural unfairness and substantive unfairness,

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[1] The conception of procedural fairness is therefore "backward-looking" in that in determining whether a contract in question is procedurally fair, one must look backwards to its formation process and detect the presence of any improper means of obtaining the contract: see Anthony T. Kronman, "*Contract Law and Distributive Justice*", (1980) 89 Yale L.J. 472, at 476 (at which procedural fairness is explained in relation to the libertarian viewpoint of the impeachment of contractual exchange).

[2] Following the House of Lords's decision in *Lynch* v. *D.P.P for Northern Ireland* [1975] 1 All E.R. 913, [1975] A.C. 653, the view that procedural impropriety vitiates consent has not been uncontroversial. (Discussion of this issue is postponed to the section of this chapter where the question of the "will theory" of contract is dealt with: see p. 69 *et seq*, *infra*.) However, it is generally accepted as the correct view.

[3] [1985] A.C. 1000 (Privy Council), at 1017.

either type of unfairness rarely stands in isolation from the other and both types closely correlate with each other, in the sense that improper means are often employed to achieve some imbalance in the result of the contract and that where there exists such imbalance it is most probably caused by some procedural taint. Given this close correlation, a dichotomy of contractual imbalance can specifically be drawn: contractual imbalance *per se* or, as it shall be called, substantive unfairness *per se* (which exists when the imbalance is genuinely intended by all contracting parties, not engendered by any procedural flaws) and contractual imbalance occasioned by procedural defects (which include *both* procedural improprieties encircled by common law *and* malprocedure involving market imperfections).

How English law has responded to unfairness in contract will be substantially explored in the next chapter. Only a few issues deserve a mention here. Contractual imbalance *per se* or substantive unfairness *per se* is no concern of the common law. The common law irons out unfairness embodied in the form of non-equivalence only when it can be fitted under the existing doctrines of fraud, misrepresentation, duress, undue influence and the equitable doctrine of unconscionable bargains, which deals with the advantage taken of circumstances or conditions of weakness of the other party (although the English position confines such condition to being a poor and ignorant person).[4]

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[4] The attack of an unfair result which is fabricated by fraud, misrepresentation, duress and 'actual' undue influence is generally conceived of as being, in nature, a major attack on procedural unfairness whereas the recission of a contract on the ground of 'presumed' undue influence and unconscionable bargains is arguably viewed as an attack not primarily on procedural unfairness, for the courts require the presence of manifest disadvantage or gross contractual imbalance (i.e. substantive unfairness) as the pre-condition for rescinding the contract. Modern writers such as Mindy Chen-Wishart or Robert Clark have apparently addressed the courts setting aside unconscionable bargains as the judicial unarticulated concern with the primacy of substantive fairness while Atiyah also asserts that equitable doctrines are clearly concerned with the substantive fairness of transactions: see respectively Mindy Chen-Wishart, *Unconscionable Bargains*, (Butterworths: Wellinton,1989), pp. 104-116; Robert Clark, *Inequality of Bargaining Power: Judicial Intervention in Improvident and Unconscionable Bargains*, (Carswell, 1987) and P.S. Atiyah, "*Contract and Fair Exchange*" in *Essays on Contracts*, (Clarendon Press Oxford, 1988), Essay 11, p. 331. For the sake of terminological clarity and the avoidance of confusion, this thesis will, despite full awareness of the lack of sharp borderline between procedural and substantive unfairness, call such contractual imbalance or unfairness as created by fraud, misrepresentation, duress, undue influence and unconscionable bargains (catching bargains) "procedural unfairness" although in some cases it might be primarily concerned with the substantively unfair result.

This thesis seeks to explore the concept of having a general rule to empower the judiciary to control unfair terms in individual contracts candidly by declaring those terms invalid. It is not directed at such unjust terms (substantive unfairness) as arise from procedural defects captured by traditional rules of contract law, either common law or equity, (and it is also felt that the works dealing with that topic are already numerous and should not be repeated by this thesis). Rather, the thesis's main concern is with unfair clauses in contracts which are concluded *even in the absence of traditional procedural improprieties in their formation process*. The paramount objective is to discover whether it is justifiable, desirable and necessary to introduce a general rule to give the courts the direct power to review such clauses or terms and, if justifications for such a rule are found, what its appropriately operational contents should be.

This chapter seeks to demonstrate that a general rule to police unfairness in the terms of a contract should not be introduced to the effect of allowing the courts to rectify substantive unfairness *per se* and that the justifications for its non-interference rest both upon economic theories (which presuppose perfect workings of the market including perfect information of all parties to an exchange and which gives rise to the "freedom of contract" maxim) and upon the observance of the "autonomy of will". However, when an unfair term of a contract is not mere substantive unfairness *per se* but has been acceded to as a result of market imperfections, the economic theories, will theory as well as other related theories have provided practical justifications for having a general rule to undo it. It will be clearly described that amongst various types of recognised market imperfections, monopoly and informational asymmetry (that is to say, the ignorance about crucial information when making a contract) are the only types of market imperfections which concern the question of unfairness in the terms of a contract as between parties. As a result, a general rule for subjecting unfair terms to judicial review can possibly be grounded on either of these two types.

Further investigation will indicate, however, that although monopoly may still exist, it is generally under control by current legislation and ceases to be omnipresent. It is, therefore, hardly a matter of necessity to introduce a general rule allowing a contracting party to escape contractual obligations on the mere ground of monopoly.

Rather, the introduction of a general rule to rectify unfairness can be justified on the ground of informational asymmetry or ignorance. Nevertheless, ignorance about the quality of the goods or services or about the availability of sources of lower prices is immaterial and no party should be allowed to have any allegedly high price rectified or struck down by the court. The sort of ignorance which accommodates a sound basis for judicial rectification of contractual terms is only one which relates to either the existence or the implications of the terms contained in written and, more often, standard-form contracts. More specifically speaking, it is the commonality of the following that entails the introduction of a general rule empowering the courts to scrutinise unfairness of the terms in individual agreements: inconspicuousness of the terms, lack of reasonable opportunity to ascertain the terms, or inability to understand the implications of the terms.

This ignorance-based unfairness falls, in large part, short of such case-law traditional procedural improprieties as fraud, misrepresentation, duress and undue influence and cannot be remedied even with an aid of the equitable doctrine of unconscionable bargains since the element of advantage-taking of circumstantial weaknesses is lacking: the use of standard forms is almost universally recognised as a manifest advantage of transaction-cost reduction rather than the advantage-taking by the non-drafting party and the use of linguistic complexities is also thought of as the product of legal technical sophistication and elegance rather than the malicious intention to create ignorance and then take advantage of it. In addition, redress under various statutes currently in force, in particular the Unfair Contract Terms Act 1977, is still insufficient since it is limited to exclusion clauses and some selected instances. For these reasons, special legislation giving the courts general jurisdiction to invalidate unfair contract terms upon evidence that the aggrieved party has entered into the contract without being aware of the existence or implications of those terms should be enacted and applicable across the board—that is to say, to all types of contracts in all instances, not only in some selected instances as is the case nowadays.

It will be explained that the application of such a general rule should not extend to both situations where the party seeking relief has made the contract in question in the course of business or trade and also where the contract is made between two non-

business parties. In addition, this general rule is justified in controlling only terms in written contracts, whether standardised or not, because where ignorance is present in the context other than that of a written contract, the element of advantage-taking of such ignorance is rather obvious, so that the unfairness in the contract terms concerned should be remedied under the equitable doctrine rather than under the same general rule.

In grasping economic theories either in support or in defiance of the rectification of unfair contract terms by a general rule, both classical and modern economic theories will be explored. Related theories such as "will theory", "objective theory" and "contract as promise theory" of contract, which have often been addressed in rejection of the control of contractual terms, will be critically examined. Wealth maximisation efficiency criterion, which has been a benchmark of the so-called "law-and-economics" school of thought, will also be embraced by the investigation in this chapter. All these will be dealt with *seriatim*.

II. SUBSTANTIVE UNFAIRNESS *PER SE*

1. Relationship between Substantive Unfairness *Per Se* and "Freedom of Contract" and "Laissez-Faire" Ideologies

As previously mentioned, substantive unfairness or contractual imbalance *per se* has been treated as no concern of the law. Individuals should fully enjoy their "freedom of contract". The foundation of this legal principle of freedom of contract receives influences from laissez-faire, laissez-passer classical economic concepts as well as Bentham's utilitarianism which emerged in the late eighteenth century and laid emphasis on letting individuals freely transact under the workings of the market with governmental abstention from interference. Atiyah has pointed out that the close relationship between classical or political economics and law was strong in the first forty years of the nineteenth century and that the reason why judges and lawyers, being non-economists, tended to be receptive to these economic ideas and took over them when determining the question of fairness in individuals' agreements, was because

works of classical economists were written in the intelligible layman language.[5] These statements seem convincing, at least when one looks at the English law of contract. In *A Schroeder Music Publishing Co. Ltd.* v. *Macaulay*,[6] Lord Diplock concedes that the judiciary has adopted laissez-faire and Benthamite utilitarianism in general cases when determining the question of whether the contract is fair in its substantive result, although some exceptional categories of contracts (including contracts in restraint of trade) have survived these economic concepts' influences. The following passage is illuminant of this:[7]

> "It is, in my view, salutary to acknowledge that in refusing to enforce provisions of a contract whereby one party agrees for the benefit of the other party to exploit or to refrain from exploiting his own earning-power, the public policy is not some 19th century economic theory about the benefit to the general public of freedom of trade... . *Under the influence of Bentham and of laissez-faire* the courts in the 19th century abandoned the practice of applying the public policy against unconscionable[8] bargains to contracts generally, as they had formerly done to any contract considered to be usurious; but the policy survived in its application to penalty clauses and to relief against forfeiture and also to the special category of contract in restraint of trade."

2. Economic Theories

The law is justified in abstaining from intervention in substantive unfairness *per se* in order to uphold freedom of contract of individuals and a general rule should not be introduced to the effect of authorising the courts to rectify any contract terms which

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[5] P. S. Atiyah, *The Rise and Fall of Freedom of Contract*, (Clarendon Press Oxford, 1979), p. 292.

[6] [1974] 3 All E.R. 616.

[7] [1974] All E.R. 616, at 623 (italics added).

[8] It should be noted that Lord Diplock's using the term "unconscionable" here does not connote the English common law doctrine of "unconscionable bargains", which originates from catching bargains (dealing with expectant heirs) cases and has been developed to extend to poor-and-ignorant-persons cases. Reference to common law unconscionable cases is the use of this term in a narrow sense. "Unconscionability" in a broader sense is referred to cases of harsh or unfair terms in contracts, the same sense as substantive unfairness or contractual imbalance which is now under discussion. In the passage above Lord Diplock referred to unconscionable in this sense, for his Lordship was in that case determining the harshness of the terms of the restraint of trade agreement before him: see p. 28, *supra* for the brief recital of facts of this case. The use of the term "unconscionable" in the broadest sense is when it includes both procedural and substantive unfairness. It is worth mentioning, for the purpose of comparison, that the common law doctrine of unconscionability in Australia, New Zealand and Canada is of a much broader application than the equivalent English doctrine: see footnote 28 in Chapter 2, *supra* for references.

portray this type of unfairness. The predominant justification for such non-intervention can be found behind both classical and modern economic theories themselves. Before commencing the investigation of economic notions, the relationship between law and economics may be worth a brief exposition.

2.1 Relationship Between Law and Economics

Although law and economics are usually conceived of as being distinct principles standing independently of each other—rules of law are established to be a device for achieving their goals of justice whereas economics is a science of rational behaviour and rational choice so as to achieve consistent ends by efficient means by which scarce or limited resources will be best allocated and transferred to more valuable hands and put in their next-best uses—there has emerged, in the last few decades, the so-called economic analysis of law (sometimes called "*economic approach to law*" or "*law and economics*") which has attempted to break the separation of these two disciplines. This approach, having its birth in the United States and having spread to other parts of the world, professes that law and economics are so closely connected that law and legal institutions can be explained in economic terms; legal rules have stemmed from arguments which are, in reality, economic in nature and the judiciary is supposed to have the role of deciding cases rationally to promote economic efficiency in the sense of allocating resources to more valuable hands and putting them in their next-best uses, as alluded to above.[9]

There is divergence in the economic approach to law.[10] Some claim that all or almost all legal rules exhibit a deep interaction that is economic in character and the law can be reduced to economics by substituting economic concepts (for example, the concept of economic efficiency) for such traditional legal concepts as justice. Some argue that although economics can be applied to legal rules across the board, such radical reductivism is unacceptable since legal concepts are moulded out of diverse

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[9] For the history of economic approach to law in the United States, see Posner, *Economic Analysis of Law*, 3rd edn., (Little, Brown and Company, 1992), pp. 21-22.

[10] Useful explanations can be found in Cooter and Ulen, *Law and Economics*, (Harper Collins, 1988), p. 10.

elements and policies apart from pure economic efficiency. Some may contend merely that economic reasoning can be applicable only to *some*, not *all*, branches of law, although these claimants may share either the reductivism or non-reductivism view as far as the economically-related branches are concerned. This appears to be the correct version since, to give a striking example, one can see that criminal law penalizes theft primarily and simply by reason of upholding social morality and justice, rather than the alleged reason that economic approach dictates and encourages the transfer of property by way of exchange to serve economic efficiency. This chapter is not a place for a full exploration of these accounts. It is concerned only with the belief that economic rationales are significant in demonstrating and justifying the non-interference with substantive unfairness or contractual imbalance *per se* in individuals' contracts. Relevant economic concepts will now be grasped in search of these justifications.

2.2 Classical Economics: Laissez-Faire, Laissez-Passer

Adam Smith has been credited with the prototype of classical economic theories. As far as freedom of contract and fairness in contracts is concerned, Adam Smith, as expressed in his work, *The Wealth of Nations*, asserts that a man has a natural propensity to truck, barter and exchange one thing for another and will exchange what he has in excess of his need for something else which can be of more utility than what he is to part with in return. "Every man", Smith says, "lives by exchanging, or becomes in some measure a merchant."[11] The State should let individuals freely transact as they please and should not interfere with their transactions. It is individuals themselves who make their own exchanges, not the State or judges and interference with individuals' exchanges is undesirable. It is not the State's duty to assure equality in individual exchanges. The foundation of Smith's belief in non-interference with substantive fairness in individual exchanges is the conviction that a man, being a rational being, is capable of judging and protecting his interests and benefits which he can obtain from an exchange he purports to make with another and, naturally, will not agree to trade off what he has in his hands for

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[11] *The Wealth of Nations*, Book 1, Chap. II and Chap. IV, cited by Atiyah, *The Rise and Fall of Freedom of Contract*, *op. cit.*, (footnote 5, *supra*), p. 296.

something else unless he is satisfied that the exchange will maximise his self-interests, happiness and pleasure. What he views as serving and maximising his best and maximum interests, happiness and pleasure to be obtained from an exchange might not be the best interests in another person's eyes; hence there is no ground for any party to allege that the substantive result of such agreement is unfair.[12]

Classical economists' belief in men's ability to protect their own self-interests also rests upon the assumption that the market is perfectly functioning. If the maximum interests, happiness or pleasure cannot be achieved from his purported exchange, rationality will direct a man to forego such exchange and, instead, look for better terms of exchange available in the market. Accordingly, those who offer hard bargains take their own risk of having their offers turned down by potential contracting parties and then losing some benefit to their competitors in the market. This is simply the natural principle of demand and supply.[13] Parties to an exchange will agree on it when self-working supply and demand curves intersect at a price or value which represents the satisfaction of both parties. The law should let the market "clear" at the price at which supply and demand are equal.[14]

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[12] For similar accounts of the search-after-self-interest rationale as presented by later classical economists, see Atiyah, *The Rise and Fall of Freedom of Contract*, *op. cit.* (footnote 5, *supra*), pp. 304-323. See, in particular, the ideas advocated by James Mill and Ricardo: *ibid.*, pp. 310-314.

[13] This is viewed by Smith as the most important of inexorable Natural Laws applicable to rational economy: see *ibid.*, p. 296 *et seq.*

[14] It is in this sense that the laissez-faire ideology has a close linkage with Bentham's utilitarianism. Bentham contends that the principle of utility or the principle of the greatest happiness of the greatest number is the conception of justice and claims that the system of letting individuals freely contract with one another will yield the greatest utility or happiness of the greatest number and that no one should be interfered with this freedom. Benthamite utilitarianism and laissez-faire are often alluded to alongside each other. (It should, indeed, be recalled that Lord Diplock stated that the nineteenth century courts' abandonment of the practice of applying the public policy against unconscionable bargains was because of "*the influence of Bentham and of laissez-faire*": see p. 6, *supra*.) Bentham's most quoted passage is the following:

> "No man of ripe years and of sound mind, acting freely, and with his eyes open, ought to be hindered, with a view to his advantage, from taking such bargain, in the way of obtaining money as he thinks fit; nor (what is a necessary consequence) anybody hindered from supplying him, upon any terms he thinks proper to accede to".

According to Smith, when the market is left free from intervention by the State, not only will it result in contracting parties' satisfaction with their own interests but there will also exist an *invisible hand* which can consequently bring about the interest of the public as a whole. In this sense, there is a natural harmony between private and public interests in the system of natural freedom. This natural harmony will automatically occur despite no such intention of the parties to an exchange at all.

2.3 Modern Economics

Modern economists' arguments also centre on the notions of rationality, maximisation of benefits and the "invisible hand". To modern economists, a man behaves rationally when he pursues consistent ends by efficient means, a situation which exists when he increases and maximises his utility. Utility can be in the form of satisfaction, happiness, pleasure or profits; but normally sellers or firms are said to maximise profit. In the market, each will choose the alternative (called preference ranking or preference ordering) which can most satisfy his preference. By spending less on X he can have a smaller quantity of X (hence, a loss in utility in X) but he can spend that saved money to buy more of Y (hence, greater utility in Y). In any shift from X to Y, the loss in utility of X is what economists call a "marginal cost" of the purchase of Y and the increase in utility in Y is its "marginal benefit". An individual will always continue buying more of Y and less of X so long as a marginal benefit of Y is greater than its marginal cost and his shift from X to Y will stop at the point where the marginal benefit can no longer be greater than the marginal cost; that is to say, the marginal cost equals marginal benefit. This point represents the maximisation of his utility.[15]

In deciding whether to buy or sell each individual item, rational behaviour instructs that the price be fixed at the point where both parties are satisfied; that is where the demand curve intersects with the supply curve. This price is an *equilibrium*

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[15] Professional economists who employ the calculus technique can present this point in the formulae max $[U(x,y) + \lambda (I - p_x x - p_y y)]$. This is rather beyond most lawyers' comprehension capacity and, therefore, this thesis is not concerned with it. See Cooter and Ulen, *op. cit.*, (footnote 10, *supra*), p. 24.

price, which represents the seller's and the buyer's maximisation of profits (for the seller) and utility (for the buyer).

Once individuals, both buyers and sellers, have maximised their utility under the mechanism of a well-functioning market, economic efficiency is automatically achieved—resources are put in their next-best use as well as allocated to more valuable hands. In this situation of maximisation and efficiency, it is impossible for a producer to be able to produce more output using the available resources. Consumers who pay for the goods consider that the goods are worth more than the value of the money paid although for the sellers those goods are less valuable than their prices. After the transaction, both sellers and buyers are better off, which will lead to the total wealth of society as a whole. This is what economists call "*social optimum*", which is a spontaneous result of individuals' maximisation behaviour itself. This concept is no more than the Smithian "*invisible hand*" conviction. In this connection, Kronman and Posner's illustration is of instructive value and worth a quotation here. If A owns a good that is worth only $100 to A but $150 to B, A and B will increase their interests and their wealth by making an exchange of A's good for B's money at any price between $100 and $150. If the price agreed is $125, A's wealth will be increased by $25 and B's by $25 (as prior to the exchange, B had $125 in cash and after such contract he possesses the good which is worth $150 to him). The result of the exchange is an increase of the wealth of society, to which A and B belong, by $50.[16]

2.4 Pareto Efficiency Compared

There has emerged a popular economic concept of Pareto Efficiency (named after Vilfred Pareto, the Italian economist and political scientist who proposed this efficiency criterion) which serves as standards to rank social states of affairs, in other words, the change from one state of affairs to another. Two concepts are often referred to by both economists and lawyers in the last few decades, to wit, "*Pareto Superiority*" and "*Pareto Optimality*". One state of affairs is said to be Pareto superior to another when the change from the latter to the former makes at least one person

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[16] Kronman and Posner, *Economics of Contract Law*, (Little, Brown and Company, 1979), pp. 1-4.

better off without making anybody worse off. A state of affairs is Pareto optimal *if and only if* any further change from this state can make someone better off only by making someone else worse off. At a later time, there has also emerged *Kaldor-Hicks efficiency*. A change from one state of affairs to another can make someone better off at the expense of another but the gain from one who is made better off can fully compensate the loss of the worse off, irrespective of whether or not the worse off is actually compensated. This change is Kaldor-Hicks efficient (sometimes referred to as "*potential Pareto superior*"). If the loser receives full compensation for the loss, the situation is turned to Pareto superiority.[17]

These Pareto efficiency concepts are also employed in relation to utility maximisation in the sense that, in the process of maximising utility, an individual attempts to make a Pareto superiority improvement until the improvement reaches Pareto optimality. A manufacturer who continues to produce goods so long as marginal revenue is greater than marginal costs is pursuing Pareto superiority improvements since, in such continuance of production, he can still be better off without making anyone worse off (leaving aside the possibility of adverse affects to third-parties, for instance, when production produces pollution to neighbouring areas). Where his marginal costs equal marginal revenue, the situation is Pareto optimal or Pareto efficient, for any move from this point can only result in a loss to him. An equilibrium price of the goods is Pareto optimal since any shift from this price level can make one party better off only at the expense of the other.

3. Application of Economic Theories to Substantive Unfairness *Per Se*: Justifications for Non-Intervention

The economic concepts of rationality, utility maximisation, equilibrium and economic efficiency, discussed above, serve as sufficient support of the argument that

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[17] For more details, see Jules L. Coleman, "*Efficiency, Utility And Wealth Maximization*", (1980) 8 Hofstra L.R. 509

In order to avoid confusion, it must be pointed out here that, often, when economists or lawyers speak of Pareto efficiency, they may merely refer to Pareto optimality although in the broader sense Pareto efficiency includes all types of Pareto improvements including potential Pareto superiority.

imbalance or non-equivalence *per se* in individual agreements concluded in a perfect market is not to be interfered by law since both parties to an exchange will, as a result of their rationally maximising their utility, be better off and achieve their ends efficiently in the economic sense previous explained. The unobjectionableness of this argument lies in the probity that an individual's judgment as regards his maximum utility (profit, benefit, happiness or pleasure) from the end result of his contract is subjective. Different individuals, in contracting with others, may have different goals and private ends to be achieved from their agreement. In some cases, what is generally regarded as a substantively unjust result may not be considered by that party as being unfair to him and, on the contrary, could even represent his maximised utility. There will be, therefore, no sense to interfere with it and declare it as substantively unfair in the face of the contracting party's wish and careful judgment. The following section attempts to set out those cases where the substantive result of a contract may normally appear too harsh or unjust but is in reality fair, voluntarily acceded to and reflective of maximised utility of the party who assumes it.

3.1 Benefit Consideration

It is not uncommon, for example, that people are willing to part with a large sum of money or other types of property in return for some idiosyncratic interest. The case of Michael Jackson's concert ticket prices can well afford the most simple but striking illustration. As part of his "Dangerous Tour" in summer 1993, this world famous pop singer gave stage performances in various countries—some with low *per capita* income levels, such as Thailand, were also included in this tour. The highest price of entrance tickets for his performance in Bangkok was fixed at 2,500 Baht. Because of a high demand for tickets, many were purchased for the purpose of resale and the tickets were ultimately sold for between 5,000 to 10,000 Baht, an amount which was then equivalent to a half-month or one-month average salary of most people in the country. Buyers who bought tickets at such a prodigious price were all well satisfied with it since they considered it worth their enjoyment of their "King of Pop"'s performance. Disallowing Michael Jackson or the resale purchasers to charge this price would have done more harm than good to the fans as they would have been unable to see their "King of Pop" (and for many fans, seeing him was one of the high spots of

their lives). Jackson may no longer have performed. Another absurd result of interfering would be that the fans would be unjustly better off—they have received their satisfactory enjoyment which they thought more valuable than the money they parted with and then can have some of this money returned to them![18]

3.2 Personal Happiness Consideration

It is not uncommon that in the making of a contract on some occasions one may not aim at any pecuniary profit. One may be concerned only with some meaningful benefit in the form of personal happiness or satisfaction from some altruistic favour. The father who makes a contract with his son may, for instance, be willing to let the son have such onerously greater benefit at the father's expense. We have at least witnessed this in *Thomas* v. *Thomas*[19] in which the executor of the deceased husband granted the occupation of a house to the surviving wife on payment of £1 a year according to the husband's wish when he was alive. The decision is absolutely right since the law should respect individuals' intention or autonomy of will. Any intervention by disallowing the husband to make a contract which is far more favourable to the wife is simply the violation of private autonomy and happiness. It is, however, regrettable that in upholding the contract in this case, the court based its decision only on the doctrine of immateriality of inadequate consideration rather than on the personal happiness foundation.

Gordley has discussed whether the control of inequality in an exchange is the violation of private autonomy in the law of contract and argues that there are two types of individuals' decision—a decision whether to enter into an agreement and a decision whether to contract on best terms available in the market. The first type of decision, his argument goes, represents completely private autonomy. Each person's decision as to whether to contract depends on his unique aspirations and circumstances which will differ from one person to another; thus the law cannot force him to contract

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[18] For an example of non-price terms which are harsh but representative of the parties' mutual benefit and maximised utility, see the discussion of the "add-on clauses" and "waiver-of-defense clauses", pp. 44, 46, *infra*.

[19] (1842) 2 Q.B. 851.

or not to contract. The decision whether to contract on the best or reasonable terms, Gordley asserts, does not actually indicate any private autonomy. *All contracting parties* will decide to contract on the best and reasonable terms whatever their aspirations and circumstances; and it follows that the court that requires the party to contract on fair terms is not infringing on their private autonomy.[20] Although Gordley's contention appears robust in the context of unfair terms or contractual imbalance acceded to as a result of market imperfections, which will be discussed later, it appears to gain no ground *vis-à-vis* substantive unfairness or contractual imbalance *per se*, for it yields the stalwart fallacy that an individual is in no wise allowed to give the other party much more favourable benefit out of any personal reason based on happiness or preference at all.[21]

3.3 Risk Aversion Attitudes Consideration

It is unrealistic to assume that everyone is risk-averse and will not seek any risk. A risk-averse person will choose the certain prospect (100%) of getting £100 rather than one-tenth (10%) probability of obtaining £1,000, although the expected monetary outcome of both choices is equal (£100). If a contract is made in the fashion of causing this risk-averse person to accept the latter in the face of his real risk attitude, the non-equivalence may be unfair to him and can hardly be perceived as the contractual imbalance *per se*. However, a number of people are risk-preferring (sometimes called risk-seeking) or risk-neutral. A risk-preferring person will opt for the second choice and a risk-neutral person will feel indifferent about these two choices. The risk-preferring or risk-neutral contracting party who has voluntarily

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[20] James Gordley, "*Equality in Exchange*", (1981) 69 Cal. L.R. 1587, at 1617-1619.

[21] This point has, in fact, been raised by liberal political theorists in response to rule-utilitarianism. For rule-utilitarians, if a legal rule to be introduced to control all contractual imbalance including contractual imbalance *per se* can result in the greatest happiness of the society as a whole, the introduction of this doctrine is justifiable. Liberal political theorists reject this and assert that the mere fact that one way of life is valuable and ought to be aspired to, while another way of life is not, does not justify us in imposing that view on others by making it the presupposed basic value of our legal system. Rather, these liberalists contend, the law should provide a framework within which everyone has the opportunity to pursue his own conception of the good life. This liberal view obviously prevails in respect of contractual imbalance *per se*.

assented to harsh contractual terms in order to satisfy his risk attitude[22] and in contemplation of some maximised utility should not be considered as suffering any unfairness in regard to the ensuing imbalance in the result of his agreement.[23] An illustration can be found, perhaps, in the case of a sale of the crop to be grown on the seller's farm which requires price payment by the buyer even in the event of the total failure of the crop. It is obvious that the sale with this proviso is intended to be not only one of expected goods (*emptio rei speratae*) but also one of expectation (*emptio spei*). The buyer, fully aware of the risk placed on him, is willing to assume this risk in return for the chance of a big profit if the crop turns out to be successful.[24] Notably, these risk attitudes are more likely to be found in self-insured traders. A buyer may contract with many sellers and the loss which may arise from his contract with one seller does not significantly affect his returns on his whole business since this loss can

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[22] For more details on risk attitudes, see Alex Y. Seita, "*Uncertainty and Contract Law*", (1984) 46 Univ. of Pitts L.R. 75, at 103 (discussing different risk attitudes in relation to inefficient breach of contract) where he explains:-

> "Risk aversion exists when an individual prefers a monetary outcome certain to occur over a gamble with an equal or greater expected monetary outcome. Risk seeking, conversely, exists when an individual rejects a monetary outcome certain to occur in favor of a gamble with an *equal* or *lower* expected monetary outcome. Finally, risk neutrality exists when a person is indifferent between a certain monetary outcome and a gamble with the same expected value." (italics added). As to the part of his exposition on the risk-seeking attitude, the word "*higher*" should be added to it, so that the more complete definition of a risk-seeking person should be a person who rejects a monetary outcome certain to occur in favour of a gamble with an *equal*, *lower*, or *higher* expected monetary outcome. Given choices between 100% chance of gaining £100 and 10% chance of winning £10,000 (with 90% chance of winning nothing), a risk-seeking person will choose the second choice which has its expected monetary outcome of £1,000 which is *higher* than the expected monetary outcome of the £100 resulting from the first choice.

Explanations on risk attitudes presented in more detailed and advanced economic terms can be found in Cooter and Ulen, *op. cit.*, (footnote 10, *supra*).

[23] It is notable that the maxim "*volenti non fit injuria*" can, in fact, apply to cases involving contractual imbalance acceded to as a result of risk-aversion attitudes. Both tort law and contract law concern private disputes as between the disputing parties. If the injured person who has consented to a tortious act cannot bring an action against the wrong-doer for damages, it is inconceivable that the law should allow the contracting party who has voluntarily consented to any unfair terms in his contract with a view to some gain to have that unfairness or imbalance rectified. *Volenti non fit injuria.*

[24] This type of sale is permitted under section 5 of the Sale of Goods Act 1979 which provides that such a contract operates as "an agreement to sell" the goods. For details, see *Benjamin's Sale of Goods*, 4th edn., (Sweet & Maxwell, 1992), paras 1-100 to 1-105 and also paras 1-077, 1-092.

be compensated by gains from other contracts he has made or purports to make with other traders or clients.

4. Externality Effects As Exceptional Intervention in Substantive Unfairness *Per Se*

Although the law has not generally interfered with substantive unfairness *per se* and it is, as has been explained, justified in so doing, we have also seen that the courts have occasionally intervened in a private agreement even when the parties have rationally entered into it with full knowledge and have achieved their personal goals from making the contract (and when no question arises of such condemnable immorality as in a contract to commit a crime, to promote sexual misconduct, to sell human organs, or perhaps to be a surrogate mother).[25] However, this policy is pursued only on the exceptional, not general, basis. Primarily, it has much to do with the prevention of adverse effects which the contract in question may have on third parties. This is in fact consistent with economic theories. Economists are well aware that an exchange between individuals sometimes not only affects contracting parties but also has a harmful impact on others who are not parties to it, or even perhaps on the public at large. Economists call third-party effects "externalities". For economists, in order that most efficiency can be generated, third-party effects from each contract must be reduced to the minimum. The judiciary's intervention in individual contracts to prevent externalities has much been witnessed at least in agreements in restraint of trade. Although the restrained party may have been satisfied with all the restrictive covenants contained in his agreement, the restraint may be viewed by the courts as injurious to the public in the sense that the public is deprived of services from the restrained party as a useful member.[26] Other instances where the law's attempt to interfere was inspired by the externality consideration have also been seen. Atiyah has found a striking illustration in the railway employment contracts by 1846 in which railway

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[25] For useful discussion of economic grounds of prohibition of such condemnable contracts, see M.J. Trebilcock, *The Limits of Freedom of Contract*, (Harvard University Press, 1993), Chap. 2, p. 23 *et seq*.

[26] For the origin of authorities, see *Mitchel* v. *Reynolds* (1711) 1 P. Wms. 181, 24 E.R. 347 (per Parker C.J.).

construction was in great boom. Many sub-contractors, who were engaged by railway companies, employed workers and attempted to clear themselves of "responsibilities" which they should otherwise have borne. In addition to low wages, those sub-contractors provided their workers with no sanitary accommodation, as a result of which there existed shanty towns, a spread of disease and consequential mental health problem, riots and social disorders. It was not only those employees who became the victims of this unjust employment but also the public at large who had to suffer these adverse effects, and so the law had to interfere.[27] Also, in agricultural tenancies, the House of Lords in the case of *Johnson* v. *Moreton*[28] concluded that the landlord could not exclude security of tenure given by the 1948 Act, since contracting out of the statute would affect the nation (i.e. the public at large) itself. Similarly, in residential tenancies, if a tenant is deprived of security of tenure, he will be in danger of being thrown out to the street by the landlord and will be troublesome to the public.[29] It must be noted that interference on this externality ground can only be exceptional. A contract made in the market between two parties does not commonly generate obvious effects of externalities as in the cases above. For this reason, it is not justifiable to undo unfairness *per se* as a matter of general rule on the ground of externalities.

III: PROCEDURAL UNFAIRNESS: EPOCH OF MARKET IMPERFECTIONS; A GENERAL RULE JUSTIFIED BY INFORMATIONAL ASYMMETRY

1. Traditional Procedural Improprieties

Theoretically, as a contract is a product of true consent of each party given in order to achieve some goal and maximised utility, common law scrutinises the course of negotiation leading up to the contract so as to ensure that such a contract is entered into genuinely out of the parties' freedom to form an independent judgment as regards

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[27] Atiyah, *The Rise and Fall of Freedom of Contract*, *op. cit.*, (footnote 5, *supra*), p. 333.

[28] [1980] A. C. 37.

[29] Atiyah, "*Freedom of Contract and the New Right*" in *Essays on Contract*, *op. cit.*, (footnote 5, *supra*), Essay 12, p. 359-361. See also Hugh Collins, *The Law of Contract*, 2nd edn., (Butterworth, 1993), Chap. 4, pp. 100-102. However, Collins's discussion of externalities seems to explain why the law *forbids* contracts of certain types of goods and services rather than why it *polices* their terms.

whether to make the contract and on what terms it should be made. Interference with this independent judgment in its formation process vitiates consent and, as a result, affects the validity of the transaction in question. Under traditional contract law, a contract can be set aside on the grounds of misrepresentation, duress, undue influence and unconscionable bargains. Misrepresentation involves one party interfering with the other's decision by giving him a false statement about some materially relevant fact(s) and thereby inducing him to enter into a transaction to which he would never have agreed had he known of the falsity. Interference by means of duress is more culpable since it involves the exercise of illegitimate threat or pressure on the other party to obtain a contract; and, with its progressive development by the courts, its application has been extended from threats to physical integrity of the person to threats to property or even economic or commercial interests.[30] Undue influence is an equitable remedy and, as clearly stated by Lindley L.J in *Allcard* v. *Skinner*,[31] is bifurcate—actual and presumed.[32] Actual influence generally shares the same philosophy as duress at common law, in that it is also concerned with the exercise of wrongful pressure on the other party. Presumed undue influence does not involve the exercise *in fact* of threat or pressure. It is merely *presumed* by law to be present in the transaction where there is a confidential relationship in which one party naturally places trust and confidence in the other. The law merely suspects that in this circumstance an abuse of confidence is more likely to exist and sets aside the transaction, unless the party with such dominating influence proves that he did not abuse the position. Finally, the "unconscionable bargain" doctrine ensures procedural transparency by setting aside the transaction if one party takes advantage of the other's circumstances of weaknesses.

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[30] For a survey of the development of the common law of duress, see, in particular, Kerr J.'s judgment in the case of *The Siboen and the Sibotre* (*Occidental Worldwide Investment Corp.* v. *Skibs A/S Avanti*) [1976] 1 Lloyd's Rep. 293, at 336.

[31] (1887) 36 Ch.D. 145, at 181.

[32] See also Chapter 2 for the subdivision of the "presumed undue influence" class following the House of Lords' decision in *Barclays Bank Plc* v. *O'Brien* [1993] 4 All E.R. 417 (H.L.).

However, in England, this doctrine has a limited application and does not extend to circumstances of weaknesses other than being a poor and ignorant person.[33]

2. Modern Procedural Unfairness: Market Imperfections and Insufficient Protection by Traditional Doctrines

Undeniably, it is a correct approach of law to ensure fair procedure in the course of negotiation leading up to the conclusion of a contract since a transaction reached under any procedural impropriety is not the fruit of true consent of the disadvantaged party and such interference with individual consent is generally accepted as being immoral. In addition to the morality ground, the economic approach also helps to explain the prevention from vitiated consent. The disadvantaged party to the procedurally flawed contract, either as a result of misrepresentation, duress, undue influence, or unconscionable bargains, is generally induced or forced to accept the contract without maximising his utility; (it is notable that this utility need not be viewed in terms of monetary value only[34]). Nonetheless, in the present world of commerce, it is not uncommon that the contract which is not procedurally flawed by misrepresentation, duress, undue influence or unconscionable bargains as embraced by common law and equitable doctrines may also be a product of procedural impropriety and thereby prevent one party from achieving his maximised utility. Our present trading era has witnessed market imperfections shaped in various forms ranging from monopoly to consumer ignorance. These market imperfections can be said to be defects "*in the procedure*" of the conclusion of a contract as well, since "fair procedure" embraces and presupposes the perfect workings of the market—a procedurally fair contract must be one reached under no influence of monopolistic practices and concluded with both parties having full understanding of the transaction

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[33] See footnote 8, *supra* for the comparison with the positions in other common law jurisdictions; and see also p. 58, *infra* (discussing the limited application of this doctrine in relation to consumers' ignorance). For the equivalent equitable doctrine in the United States, see Chapter 4, *infra*.

[34] Where the party is happy to possess his property but sells it to the other under threat of life, the threatened party's utility obviously drops even if the coercing party offers a price higher than its market price, for the loss in the coerced party's utility, measured in terms of happiness or preference, can be greater than the gain of his utility measured in terms of monetary value.

and its implications. It is of no sense to restrict "fair procedure" to the improprieties captured by existing traditional common law and equitable doctrines.

Indeed, the recognition that a procedurally fair contract must be also free from market imperfections is also found in economist lawyers' writings. Amongst such works, Cooter's and Ulen's *Law and Economics*[35] appears to be the most advanced in terms of applying sophisticated mathematical methods, as used by professional economists, to explain economic theories and relate them to law. In their chapter on an economic theory of contract, they have advocated that the purpose of contract law is to help people achieve their private purposes through the enforcement of promises. Promises, they assert, should be enforceable when doing so helps the affected parties achieve their ends through voluntary agreements. (This achievement of private ends, unarguably, exhibits the same sense as the fulfilment of maximised utility which has been discussed earlier.) Cooter and Ulen reiterate that contracts by which the parties have achieved their ends are "perfect contracts" and perfect contracts can result, apart from the unarguable "individual rationality", only from the perfect contractual environment[36] (that is to say, perfectly competitive market). It is noted that a classical contract lawyer like Gordley seems to have a similar view. Gordley, in his "*Inequality in Exchange*" which prominently suggests that exchange should require equality, discusses inequality in the form of the price other than a competitive price in the market and concedes that the party normally accepts this price because of his ignorance of the best available price. Gordley seems to conceive of such unawareness as "procedural unconscionability" since, to him, one cannot describe "procedural unconscionability" except as a circumstance that prevents a party from obtaining a market price and the term "bargaining disadvantage" (procedural unconscionability) should be broadly defined and not confined to a flaw in the bargaining process as in fraud, duress or mistake.[37]

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[35] *Op. cit.*, (footnote 10, *supra*)

[36] *Ibid.*, p. 227.

[37] Gordley, "*Inequality in Exchange*", *op .cit.*, (footnote 20, *supra*), at 1634-1636. It must be noted that although one can agree with Gordley in viewing ignorance as procedural unfairness, this chapter will demonstrate later that mere ignorance of market price is not a ground for relief and the type of

The granting that market imperfections fabricate procedural defects in contracts made in the present world of commerce is significant. It has much relevance to the exploration of the concept of having a general rule to scrutinise contract terms. As a procedural defect is generally conducive to some kind of unfairness in the terms of the contract, the question which needs to be answered is undoubtedly whether any type of market imperfections can be accepted as justifications for having a general rule for undoing contract terms. Although many commentators have argued that the general principle of fairness is called for by the omnipresence of market imperfections, this cannot be taken for granted. The remaining sections will be devoted to investigating this question.

3. Types of Market Imperfections Concerning Procedural Unfairness *inter partes*

Although many phenomena are normally categorised by economists as market imperfections, not all of them concern procedural unfairness in individual agreements which requires remedies under the law of contract. When Cooter and Ulen speak of the requirement that perfect contracts be made only in the perfect contractual environments (or, as they can be understood as saying, the perfect market), they enumerate the following as the components of the perfection. First, such a contract does not have any adverse effects on those who are not parties to it. Secondly, each decision-maker has full information about the nature and consequences of his choice. In the event of incomplete or asymmetrical information, the decision which appears to be rational may prove to be irrational if the decision-maker could only have made the

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ignorance in respect of which relief should be given is ignorance of complex terms in a contract: see p. 36, *infra*.

It should be borne in mind also that defects in the procedure are closely linked to the outcome of the contract. For this reason, some scholars view harsh terms to which consumers acceded because of their ignorance as the case of *substantive unfairness*. An example can be found, at least, in Atiyah's writing where he discusses the incidence of such market imperfections as monopoly and consumer ignorance under the framework of substantive unfairness: see Atiyah, "*Contract and Fair Exchange*", *op. cit.*, (footnote 4, *supra*), pp. 343, 351, in particular. Care must be specially taken when reading the term "substantive unfairness" in such context and it must be realised that by "substantive unfairness" in the very context the writers do not mean "substantive unfairness *per se*". On this basis, when, for example, section § 2-302 of the United States U.C.C. is criticised by some writers as being the intervention in the substantive dimension, those critics must *not* necessarily be understood as saying that the section intervenes in substantive unfairness *per se*.

decision with full information. Thirdly, there must be enough buyers and sellers. Lastly, the process of executing the transaction has no cost. The first type of market failure is obviously the existence of externality effects which have been earlier discussed.[38] The second is often referred to as "imperfect information" or "informational asymmetry". The third undoubtedly involves monopoly. The fourth involves cost minimisation, which will be explained in due course. In addition to the commonly spoken monopoly, externality and informational asymmetry, Veljanovski[39] also includes as another type of market failure "public goods", which will be expanded upon shortly.[40]

Amongst these existing types of market imperfections which attract intervention by law, only monopoly and informational asymmetry are the phenomena which concern procedural impropriety or unfairness as between the parties in the contract, in respect of which intervention by undoing contract terms is carried out on the *inter partes* basis. Intervention in respect of externalities and public goods is not directed at the correction of unfairness between the contracting parties as such. As previously discussed, the control of terms on the ground of externalities points to the policing of the substance of the term with an eye principally to preventing loss to *third parties*. With regard to "*public goods*", intervention in this type of market failure is not a matter of correction of any sort of unfairness in private contracts at all. It only involves legal policies to require the so-called public goods (which are those goods that exhibit the dual characteristics of non-rivalrous consumption and non-excludability) to be primarily supplied by the government instead of being privately owned since, if these goods are privately supplied in the mechanism of the competitive market, the level of supply will usually be adversely deficient or sub-optimal. This is because when the consumption of such goods does not exclude any other individuals from consuming the goods as well (and when the costs to a private supplier of excluding non-paying beneficiaries are high), most people are likely to prefer being

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[38] See p. 17, *supra*.

[39] Veljanovski, *New Law-and-Economic*, (Centre for Socio-Legal Studies: Oxford, 1982), p. 45.

[40] See also Atiyah, *The Rise and Fall of Freedom of Contract*, *op. cit.*, (footnote 5, *supra*), p. 116 (discussing monopoly), pp. 620-625 (discussing externalities and consumer ignorance).

"free-riders".[41] The government therefore intervenes, either by being the primary supplier of these goods with the costs being paid from general tax revenues, or by letting them be provided by private entrepreneurs with governmental subsidies from tax revenues. In this sense, "public goods" as a market failure has a great deal to do with determining how property law can facilitate private exchange rather than with the question of unfairness in a contract between the parties.

Finally, as for the contention, as made by Cooter and Ulen, that a contract must be one that incurs no cost in its execution, this has nothing to do with procedural defects *vis-à-vis* the contracting parties either. Intervening in a contract the executing process of which is costly is merely an attempt to achieve efficiency by minimising transaction costs; and in fact such an effort to minimise costs is not confined to the contractual context but has long been appreciated since, in particular, the emergence of the "*Coase Theorem*" as proposed by Ronald Coase in his famous article "*The Problem of Social Cost*"[42] in the context of how to make the choice of legal rules (to assign rights) in the real world of positive transaction costs so as to minimise the effects of these costs and, as a result, achieve the efficient outcome.[43]

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[41] An instructive and helpful illustration can be found in Cooter's and Ulen's explanation: "Suppose that a particular city block is plagued by crime, so some residents propose hiring a private guard. Many residents will voluntarily contribute to the guard's salary, but suppose that some refuse. The paying residents may instruct the guard not to aid non-payers in the event of a mugging. The presence of the guard on the street, however, will make it safer for *everyone*, whether they paid or not, because muggers are unlikely to know who has and who has not paid for the guard's services": see *op. cit.*, (footnote 10, *supra*), p. 109.

[42] R.H. Coase, "*The Problem of Social Cost*", (1960) 3 J. of Law & Econs. 1.

[43] In proposing this theorem, Coase concedes that activities and interests of individuals clash and conflict. When the rule of law assigns a particular right to any class of people to carry on some activities, those activities which benefit one individual normally inflict harm or loss on others; but in the world of zero transaction cost, the efficient outcome will occur irrespective of to whom the legal rule assigns that right since, if bargain is cooperative and there are no (or low) transaction costs, the affected parties will bargain and negotiate until they exhaust potential mutual gains from exchange and achieve the efficient level of harm and minimise the joint-social costs of their activities. But when transactions in the real world always incur costs, a different delimitation of rights by the law may lead to a different outcome in terms of efficiency and, thus, it would be desirable that the law and the courts should take these consequences into account and then assign rights in a manner which minimises the effects of transaction costs. The standard example given by Coase is that of a factory which emits smoke that has harmful effect on occupying neighbouring properties. But see also his cattle raiser-farmer example: *ibid.*, p. 2. For a more simplified illustration, see also Cooter and Ulen, *op. cit.*, (footnote 10, *supra*), pp. 4-6. The simplest and most instructive example is found in

As this thesis is concerned merely with the question of the unfairness in contracts *vis-à-vis* the contracting parties only, the relevant types of market imperfections which fall within the scope of the investigation here are thus limited to monopoly and informational asymmetry (ignorance). The next section will explore whether these types of market failure exhibit any justification for a general rule to be introduced into the law of contract to rectify unjust results which are generated by them.[44]

4. Monopoly

Where there exists a single seller or buyer in a market, that trader has the ability to restrict output and raise the price of his goods above the otherwise competitive price. From the viewpoint of efficiency, this monopoly price is too high. Obviously, consumers are unable to behave rationally and maximise their utility since it is impossible for them to have their meaningful choice. If the goods are the kind which can be substituted by other goods, consumers may still have alternative choices from the market. In contrast, consumers of necessary goods which cannot be substituted by any other kinds of goods will be victims of monopolists. Smith and other classical economists were not unaware of the existence of this market failure but they viewed this incidence as so scarce that it was not worth their concern; and, as a result, they were principally content with self-regulation of the market and non-interference by the State.[45] However, in later times, monopolistic practices became more common. A special monopoly is a cartel which is collusion amongst otherwise competitive

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Polinsky's An Introduction to Law and Economics, 2nd edn., (Little, Brown and Company, 1989), Chap. 3, p. 11.

[44] This approach is in agreement with Trebilcock's. Trebilcock explores the doctrine of unconscionability with an adoption of an economic perspective and believes that any doctrine of unconscionability will often be directed at what are perceived to be imperfections in market activity. To Trebilcock, two criteria are central in fashioning economically defensible criteria of unconscionability. First, a structurally-impaired market may provide grounds for judicial refusal to enforce the transaction. Secondly, in a structurally-sound market, the transaction may be suspect if made under its informationally-impaired condition: see Trebilcock, *"An Economic Approach to the Doctrine of Unconscionability"*, in *Studies in Contract Law*, Reiter and Swan ed., (Butterworths: Toronto, 1980), Study 11, p. 379. Although this thesis pursues the same analysis, it attempts to propose different conclusions: see *infra*.

[45] Atiyah, *The Rise and Fall of Freedom of Contract*, *op. cit.*, (footnote 5, *supra*), pp. 299-300.

suppliers in order to operate as a joint profit maximising monopoly. This kind of monopoly was found at the beginning of the twentieth century when traders pooled together for the purpose of gaining exclusive control of the market and then agreed on a resale price maintenance for their goods. *Thorne* v. *Motor Trade Association*[46] is illustrative of this practice.

Another striking illustration can be extracted from the often quoted American case of *Henningsen* v. *Bloomfield Motors Inc.*[47] which concerned unconscionability of certain warranty terms of an automobile manufacturer. On the facts, it appeared that almost all major automobile manufacturers were members of the Automobile Manufacturers Association which altogether controlled 93.5 per cent of passenger-car production at that time and the harsh terms of the warranty were fixed by this Association under a uniform form. The New Jersey Supreme Court struck down the terms on the ground of unconscionability, taking into consideration the fact that under this cartelisation the buyer could not obtain better terms from the market. The court said: "The gross inequality of bargaining position occupied by the consumer in the automobile industry is thus apparent. There is *no competition* among car makers in the area of the express warranty. *Where can the car buyer go to negotiate for better protection?*".[48] It might be argued that the buyer could still have alternative choices in the market by buying from manufacturers not belonging to the Association; however, these alternatives were too few to be significant, given that 93.5 per cent of car production was controlled by the Association.

From the twentieth century onwards, another category of cases which may seem to contribute, in some measure, to monopolistic effects are those involving restrictive trading agreements under which a number of traders seek to regulate the

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[46] [1937] A.C. 797. This case is also discussed in Chapter 2. For other examples, see cases cited in *Benjamin's Sale of Goods, op. cit.*, (footnote 24, *supra*), para 3-037. The citation includes *Elliman Sons & Co.* v. *Carrington & Son Ltd.* [1901] 2 Ch. 275; *Palmolive Co.Ltd.* v. *Freedman* [1928] Ch. 264; *Imperial Tobacco Co. Ltd.* v. *Parslay* [1936] 2 All E.R. 515. The courts in these cases held resale price maintenance agreements binding *inter partes*.

[47] (1960) 161 A.2d. 69.

[48] (1960) 161 A.2d. 69, at 87 (italics added).

conditions under which they will deal with outside traders. Apparently, this category may result in a market having fewer sellers or suppliers of similar goods and services.

Common law has established rules dealing with monopolistic conducts but its treatment of monopoly is restricted to the rectification of harsh prices which arise from the so-called "situational" or "bilateral" monopoly which is the case where the monopolistic power is not possessed on a pervasive basis but is caused to exist as a result of some special circumstances depriving one contracting party of effective access to a workably competitive range of alternative choices in the market. A category of salvage agreements can be reflective of this position.[49] The captain of a ship which becomes disabled and will shortly sink but for an immediate rescue by a tug operator will obviously have no time to choose salvage companies and any tug which appears on the scene is thus rendered by this situation to be in a monopolistic position. Any rescue price stated by the captain of the tug will, howsoever onerous it appears, be agreed by the ship's captain (provided that the value of the ship combined with its cargo still exceeds that price and that the total loss is not sufficiently indemnified by insurers). Common law allows the tug operator to receive only a reasonable fee.[50]

When common law has sought to rectify unfairness caused by situational monopoly, the question arises as to whether there is any practical justification for introducing a new general rule in the law of contract to empower the judiciary to amend unjust terms in an individual contract which are caused not by situational monopoly but by relatively pervasive monopoly such as cartelisation. Trebilcock calls this non-situational monopoly "market-wide monopoly" and asserts that the courts

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[49] For example of salvage agreements, see *Akerblom* v. *Price* (1881) 7 Q.B.D. 129, per Brett L.J. at 133 and *The Anna* [1903] P. 184, cited by Lord Denning M.R. in *Lloyds Bank* v. *Bundy* [1974] 3 All E.R. 757, at 765.

[50] Some economist lawyers have a more extensive view of situational monopoly. They assert that situational monopoly should also embrace cases of economic duress: see for example, M.J.Trebilcock, *"An Economic Approach to the Doctrine of Unconscionability"*, *op. cit.*, (footnote 44, *supra*), pp. 392-396. See also Trebilcock, *The Limits of Freedom of Contract*, *op. cit.* (footnote 25, *supra*), pp. 85-87. Similarly, Posner seems to discern the situation in salvage cases and the like as a branch of duress which he, in turn, regards as a synonym of monopoly. To Posner, where A finds B wandering lost in a snowstorm and refuses to help him until B promises to give A all his wealth, B should be excused from having to make good on the promise: see Posner, *Economic Analysis of Law*, *op. cit.*, (footnote 9, *supra*), p.114.

should be slow to intervene in such a case where the plaintiff alleges to be the victim of this type of monopoly. His contention for non-intervention is based on two reasons. First, the courts are frequently likely to draw inferences of monopoly incorrectly. According to Trebilcock, the courts, as is particularly seen from the House of Lords' decision in *A Schroeder Publishing Co. Ltd.* v. *Macaulay*,[51] tend to perceive the use by the business of standard-forms as the possession of the monopolistic power *vis-à-vis* consumers despite no existence of a significant degree of market concentration.[52] However, Trebilicock's invocation of this reason as the support for non-interference with unfairness which is alleged to have arisen from a market-wide monopoly appears conceptually inconceivable and irrelevant. In order to advocate justifications for not meddling with contractual unfairness caused by monopoly, it must be shown, first, that monopoly exists and, then, explained that some reasons outweigh the rectification of such unfairness. But, in the situation as in *Macaulay's case*, no monopoly exists in the first place at all. The case, in truth, concerned an agreement between a young song writer and music publishers whereby the former assigned to the latter the full copyright for the whole world in songs composed or to be composed by the former for the period of 5 years in return for the initial royalty of £50 and further royalties if the works were published but the publishers undertook no obligation to publish any of the writer's compositions. The agreement was terminable by the publishers on one month's notice but there was no corresponding provision in favour of the composer. The contract was made in an ordinary market without any monopolistic element. The question to be determined by the House of Lords in this case was, in fact, merely whether the restrictions were contrary to public policy and void as being an unreasonable restraint of trade. However, the House went so far as to consider the fact that the contract was contained in a standard form, for the Lords felt that this fact, *inter alia*, cast light on the reasonableness of the restrictions.[53] In the result, these restrictions were held unreasonable on the ground that the publishers, undertaking no

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[51] [1974] 3 All E.R. 616.

[52] Trebilcock, "*An Economic Approach to the Doctrine of Unconscionability*", *op. cit.*, (footnote 44, *supra*), pp. 396-400.

[53] See [1974] 3 All E.R. 616 per Lord Reid at 622 and per Lord Diplock at 624.

obligation to publish the writer's compositions, sterilised the writer's works without offering anything in return except the initial payment of £50; the restrictions were, therefore, not necessary for the protection of the legitimate interests of the publishers.

His second, and relevant, reason is that even though the use of a market-wide monopoly power is actually present in the contract in question, the courts do not have at their disposal the remedial instruments required to foreclose all second-order substitution effects which will be likely to be generated by the withholding of enforcement of such contract and, therefore, should not intervene. Trebilcock's invocation of the "second-order substitution effects" is directed at the economic incentives impact—the trepidation that the firm affected by the judiciary's fiat may be led to decide to discontinue that business and find any other substitute. He concludes that although this is not to condone the abuse of monopoly power the monopoly problem has to be dealt with by appropriate anti-trust action or full-scale public utility regulation, not by tangential private law rules.[54] This contention deserves special attention. If this is interpreted as meaning that where a legal rule empowering the courts to undo contractual unfairness emanating from a market-wide monopoly is introduced under the umbrella of the law of contract it will yield displacement effects but if the same rule is placed under the scheme of anti-trust law such displacement effects can be avoided and therefore the rule should be introduced as part of anti-trust law, it might sound convincing at first glimpse but appears conceptually illogical at further perusal, for if the same rule can produce such adverse impacts, such impacts should be persistent irrespective of its location. Therefore, justifications for non-intervention in unfair results of monopolistic contracts should lie in something else.

In this regard, it is suggested in this thesis that there is no sufficient room for introducing a rule giving the courts the general jurisdiction to rectify unfair terms in individual contracts across the board merely on the ground that such terms are engendered by the force of pervasive monopoly. But the correct reason does not surround the contrast of the avoidance of economic displacement effects under

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[54] *Op. cit.*, pp. 403-404.

different branches of law in the sense which Trebilcock seems to assert. Rather, it is based on the reality that market-wide monopoly is now generally under control by various current statutes which have as their objective the prevention of monopolistic practices in the market, so that it is hardly a matter of necessity to introduce a general rule to allow the courts to amend the end result of an individual contract on this ground. Whereas antitrust laws have forestalled continuance of monopoly in the United States and other countries, a number of statutes have been in force in England for the identical purpose. Detailed treatment of these statutes is beyond the scope of this thesis so that the following is only a brief exposition.

In the contexts of resale prices maintenance and restrictive practices, legislation of 1976 has consolidated various scattered provisions.[55] The Resale Prices Act 1976 prohibits the enforcement of minimum resale price maintenance agreements, both those concluded on a collective basis and those individually agreed. In regard to the collective enforcement, section 1 makes it unlawful for two or more suppliers to withhold supply of goods from dealers who resell or have resold goods in breach of any condition as to the price at which those goods may be resold, or to refuse to supply goods to such dealers except on terms and conditions less favourable than those offered to other dealers, or to supply goods only to persons who undertake to take such withholding or refusal. This section is obviously targeted at the prohibition of boycott or discrimination by suppliers against dealers who do not comply with their collective resale price maintenance arrangements. Similar agreements by dealers to boycott or discriminate against suppliers by withholding orders for goods from those who do not supply goods subject to a resale price condition or who refrain from enforcing such a condition are also prohibited by section 2 of the Act. On a non-collective basis, an individual contract for sale between a supplier and a dealer which includes a term and condition purporting to establish the resale price maintenance is also affected by Part II of the Act which renders it unlawful for a supplier to make such

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[55] For the historical background of this consolidated legislation, see Raybould and Firth, *Law of Monopolies: Competition Law and Practice in the USA, EEC, Germany and the UK*, (Graham & Trotman, 1991), pp. 434-437; *Chitty on Contracts*, 27th edn., (Sweet & Maxwell, 1994), Vol. 2, paras 40-002 to 40-003.

a contract and declares such a term and condition void.[56] Only small categories of goods have been exempted from the operation of the Act by the Restrictive Practices Court upon application made to it by the Director-General of Fair Trading or any affected suppliers or trade association representing them. The Court's leave will be granted only in the interest of preventing any detriment to the public which will occur if the minimum resale price maintenance is not allowed.[57] Likewise, most restrictive trading agreements are now governed by the Restrictive Trade Practices Act 1976 which requires that agreements, between two or more persons, relating to the production, supply of (which includes acquisition) or application of manufacturing process to goods, that contain *restrictions* of the kinds prescribed by the Act must be furnished to the Director-General of Fair Trading to be registered and then referred to the Restrictive Practices Court to determine whether the restrictions are in the public interest. The restrictions are void if declared to be *contrary to the public interest*[58]; and the Court may make an Order restraining the parties from giving effect to them or from making or operating any other agreement to the like effect. The restrictions which attract the application of the Act are normally those matters likely to forestall competition. These include the restrictions regarding prices to be charged or quoted and the persons to or from whom or areas or places in or from which to supply, acquire or apply the manufacturing process of the goods.[59] The scrutiny by the Act is also extended to restrictive agreements relating to *services* prescribed in the statutory instrument[60] and by the Restrictive Trade Practices (Services) Order 1976, almost all services have been brought under control.[61,62]

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[56] See Resale Prices Act 1976, s. 9(1), (2).

[57] The Court may make an exempting Order when it is satisfied, for example, that without the maintained minimum resale prices the goods would be sold by retail under conditions likely to cause danger to health in consequence of their misuse by the public as such consumers or users: see s. 14(1)(c). Since the operation of the Act, the only exempted goods are now books and medicaments.

[58] See Restrictive Practices Act 1976, ss. 6(1), 10 and 43(1).

[59] See *ibid.*, s. 6(1) (a)-(f). For example, see also *Re British Basic Slag's Application* [1963] 1 W.L.R. 727.

[60] *Ibid.*, s.11(1).

[61] See *Chitty on Contracts, op. cit.* (footnote 55, *supra*), para 40-124.

In addition, the Fair Trading Act 1973 and the Competition Act 1980 have more specifically been tailored to control monopoly in the supply of goods and anti-competitive practices respectively. The Fair Trading Act 1973 has established the mechanism to rectify a "*monopoly situation*" which is defined as a situation in which at least one quarter of the goods or services of a particular description are supplied by or to one and the same person, or by or to members of the same group. In other words, this is the situation where a supplier or buyer has a holding of at least 25 per cent share of the market for goods or services of any description.[63] The Act empowers the Director-General of Fair Trading, or the Secretary of State, or the Secretary of State and any other Minister acting jointly, to make a monopoly reference to the Monopolies and Mergers Commission where there are *prima facie* grounds for believing that a monopoly situation exists or may exist.[64] On a monopoly reference, the Commission is to investigate and make a Report as to, briefly speaking, whether a monopoly situation exists, in favour of what person(s) it exists and, most importantly, whether any facts found in the investigation operate or may be expected to operate *against the public interest*.[65] If the Commission concludes in the Report that a monopoly situation exists and operates or may be expected to operate against the public interest, it is obliged to consider remedial or preventive action in relation to the adverse effects to the public.[66] Following the Commission's Report with such conclusion, the appropriate Minister is empowered by section 56 of the Act to make an Order by statutory instrument to regulate conduct in accordance with Schedule 8 of

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[62] The Secretary of State is empowered by the Act to make on Order by statutory instrument extending its operation even to *information agreements* relating to goods and services to the effect that an agreement between two or more persons which provides for the furnishing of information in respect of the matters similar to those prescribed in the case of restriction (for instance, information about prices charged or quoted or persons to or from whom goods or services are available) to each other or to other persons is also required to be registered and determined by the Court: see ss. 7(1), 12.

[63] See Fair Trading Act 1973, ss. 6, 7.

[64] *Ibid.*, ss. 9, 50(1), 51(1).

[65] *Ibid.*, s. 49(1).

[66] *Ibid.*, s. 54(3).

the Act.[67] An Order may, for instance, require termination of certain tying arrangements, or prohibit the discrimination in prices for goods or services or the charging of prices different from published list prices, or regulate prices to be charged for any goods or services specified in the Order.[68] At the extreme, an Order may even be made to the effect of providing for the division of any business or any group of interconnected bodies corporate.[69] However, the Secretary of State may, instead of exercising powers to make such orders, request the Director-General to seek undertakings from the parties concerned to prevent or remedy the adverse effects.[70]

The Competition Act 1980 is more radical in relation to the investigation of a monopoly. This Act empowers the Director-General of Fair Trading to initiate investigation even without the prerequisite condition regarding the size of market share holding of persons to be investigated (as is the case under the Fair Trading Act 1973 above). Under the 1980 Act, the Director-General can undertake an inquiry simply where it appears to him (even without a *prima facie* case) that a course of conduct pursued by the suspect trader *may* amount to an "*anti-competitive practice*" which is, under section 2(1), a course of conduct that, of itself or when taken together with a course of conduct of associated persons, has or is intended to have or is likely to have the effect of restricting, distorting or preventing competition in connection with the production, supply or acquisition of goods or services in the country.[71] When the

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[67] It is worthy of observation that the fact that an Order can be made *only when* the Commission has concluded that the monopoly situation in question operates against the public interest indicates that the gravament of the Act is not the outright prohibition of a monopoly *per se*. At least, the legislators seem to be well aware, for example, that the dominant market power may justly arise as a result of the firm's patent. Rather, the Act's objective is to scrutinise the conduct of the firm which has the monopoly power and ensure that it does not use such power in a manner which adversely affects the public: see Raybould and Firth, *op. cit.*, (footnote 55, *supra*), p. 469.

[68] See Fair Trading Act 1973, Schedule 8, Part I. For examples of the Orders made under this Act, see *Chitty on Contracts*, *op. cit.* (footnote 55, *supra*), para 40-205 (at note 89 thereof).

[69] *Ibid.*, Schedule 8, Part II, para 14.

[70] *Ibid.*, s. 88.

[71] For examples of anti-competitive practices which have been investigated under the Act, see Raybould and Firth, *op. cit.*, (footnote 55, *supra*), pp. 517-522. These include the supplier's practice of refusing to sell its products to certain multiple retailers; the practice by which the dominant supplier of local newspapers in one area provided its conditions of supply to newsagents to the effect that newsagents should not distribute any competitive publication to the newspaper's own reader, so

Director-General has made his Report concluding that a course of conduct investigated *does* amount to an anti-competitive practice and that it is appropriate to make a competition reference to the Monopolies and Mergers Commission, undertakings to, for instance, refrain from such practice, may be offered by the trader to be accepted by the Director-General. Failing the acceptance of such undertakings or in the case where the given undertakings have subsequently not been complied with, the Director-General may make a reference to the Commission to conduct a full enquiry into whether an anti-competitive practice was actually pursued and, essentially, has operated or might be expected to operate *against the public interest.*[72] The Commission will then make a Report to the Secretary of State and when the Report concludes that an anti-competitive practice did exist contrary to the public interest, it is under duty to suggest the appropriate remedial or preventive action. Following the Commission's Report, the Secretary of State may request the Director-General to seek appropriate undertakings or make an Order prohibiting a person named in the Report from engaging in the specified practice or any other course of conduct similar in form and effect to that practice. The Act also allows the Secretary to have resort to the same powers as are given to him under Part I of Schedule 8 of the Fair Trading Act 1973 which include the powers as mentioned above in the context of references involving a *monopoly situation.*

Finally, it should be recalled that as the United Kingdom is a member of the European Community, the competition rules under the EEC treaty have become part of English law; and in the context of the prevention of monopolies, some conduct may be void or unlawful under Articles 85 and 86 of the Treaty. Briefly speaking, Article 85 prohibits agreements of cartel nature which may affect trade between Member States and which are intended to prevent, restrict or distort competition in the Community. The types of anti-competitive arrangement given by this Article include those which fix prices or other trading conditions; those which limit or control production, markets, technical development or investment; those which share market or supply; those which

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that it would be more difficult for a competing publication which distributed free in that area to reach the readership market.

[72] Competition Act 1980, s. 5.

apply dissimilar conditions to equivalent transactions with other trading parties, thereby placing them at a competitive disadvantage; and those which impose on the other party supplementary obligations unconnected with the subject of the contract. The EC Commission may, under Article 85(3), exempt conduct which falls foul of this Article from its application at least only if it contributes to improving the production or distribution of goods or to promoting technical or economic progress *while allowing consumers a fair share of the benefit*. Article 86 monitors conduct of undertakings which hold a dominant position within the common market and prohibits any abuse of such position. The examples of abuse given by this Articles are similar to those instanced by Article 85 above. Although these EEC provisions are directed *at interstate trade* rather than mere *national trade*, the benefit from its protective effects also falls on consumers in England in terms of promoting plurality of traders. [73]

In view of these statutory provisions, monopolies are generally under control and provide so trivial a justification, if not none, for having a general rule in the law of contract allowing each party to allege that the unfair result of the contract was caused by monopoly and needs rectifying. Although it is undeniable that the legislative measures for monitoring monopoly have not yet been perfected and that some gaps need to be filled if monopoly is to be more effectively deterred, this can be done in the direction of the reform of the monopoly legislation itself.[74] It is just a matter of no importance to introduce a remedy on the mere ground of monopoly. It may be argued that although these legislative provisions deal with monopoly, their treatments are merely in the form of *either* prohibiting monopolistic conduct at the outset, as in resale price maintenance agreements, *or*, in instances where such outright prohibition is not the case, investigating it and, if it has been pursued contrary to the public interest, normally stopping it from being further pursued, without directly giving any remedy to

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[73] For full details of Articles 85 and 86, see Raybould and Firth, *op. cit.*, (footnote 55, *supra*), pp. 205-295 and 321-355 respectively.

[74] For example, one of the dissatisfactions with regard to "restrictions" under the Restrictive Trade Practices Act 1976 is that the Director-General of Fair Trading has no power to enter premises and search for evidence of illegal restrictions. In this regard, the UK government has proposed the new legislation to replace this Act and fill the gaps left by it: see Raybould and Firth, *op. cit.* (footnote 55, *supra*), p. 452.

individual contracting parties who have already suffered unfair results caused by such conduct prior to its deterrence. In response to this argument, it can be said with a certain degree of confidence that although such proposition is undeniable, monopolies in the present world of commerce are too rare to entail a general rule which will have the effect of redressing the end results of individual contracts *across the board.* Although no statistical evidence can be given here to indicate this rarity, it can generally be visualised in the context of necessities. After all, if this rarity is still contested, it should be achieved through the reform of the law on monopoly rather than under the framework of any general rule undoing contract terms. In cases involving luxury items, purchasers who accept monopolistic prices or terms most probably consider them worth the goods, with the result that the purchase in this context well reflects the purchaser's rationality and maximisation of utility. Most probably, such maximised utility may rest upon the distinct quality of the goods or the manufacturers' patent or trade reputation. This rationality and maximisation is more easily envisioned in the context of businessman contracts. Given that all firms strive for profits, a firm which has entered into an agreement with another party which possesses a monopolistic power must have believed that the deal would be beneficial despite the monopolised price or other terms, so that it would be illogical to allow rectification of any contract term on the mere ground of monopoly. Pivotal justifications for intervening in unfair terms of individual contacts lie, rather, on the other type of market imperfection—informational asymmetry, which will now be discussed below.

5 Informational Asymmetry: Consumer Ignorance

5.1 Ignorance Relating to the Quality of Goods and Services or Sources of Lower Prices

It is not uncommon that individuals or consumers in the market may not make a rational choice and obtain maximum satisfaction because of their ignorance or misunderstanding. Atiyah, in his *The Rise And Fall of Freedom of Contract*,[75] appears to attach much weight to the fact that consumers become unable to understand the

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[75] *Op. cit.*, (footnote 5, *supra*).

nature and quality of the goods produced in our modern world of highly advanced technology and, as a result, fail efficiently to judge how much price to trade off for such commodities. This, Atiyah believes, provides manufacturers with opportunities of fixing an unreasonably high price incommensurable with the quality of the goods. As he puts it:[76]

> "Consumers who, in the days of Adam Smith, might have been trusted to judge of the quality of simple goodstuffs, or cloths, available for inspection, was now faced with a great array of electrical and mechanical gadgets, of man-made cloths and pre-packaged foodstuffs, whose qualities could not be perceived by simple inspection."

Atiyah's claim seems erroneous and unattractive here. Obviously, his argument is directed at rectifying harsh prices where consumers make a wrong judgment owing to the lack of a full understanding of the quality or internal composition of the goods purchased. This type of ignorance may not be a practical ground for allowing the courts to intervene in prices paid. In buying goods available in the market, layman consumers of general commodities are normally concerned merely with the generally acceptable quality of the goods. It is difficult to imagine that they care about the product's internal composition. The price is normally paid for the product being fit to be used as it is reasonable to *expect* of it. In this regard, the laws of sale in most countries have already afforded sufficient protection by requiring goods to be of merchantable or satisfactory quality, as in England is reflected in section 14(2) of the Sale of Goods Act 1979.[77] In effect, ordinary buyers of even high-tech electronic items also pay for this level of quality of the goods. For instance, when a research student buys a computer to be used for the writing of his thesis but is, at the time of purchase,

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[76] *Ibid.*, p. 624.

[77] Section 14 (2) provides: "where the seller sells goods in the course of a business, there is an implied condition that the goods supplied under the contract are of satisfactory quality... ." Further, any damage as may be caused by an internal defect of the goods can be remedied under the law of tort or product liability.

As for damage caused by defects in products, consumers are also given protection under Part I of the Consumer Protection Act 1987 which, implementing the EEC Directive 85/374, imposes on manufacturers a strict liability regardless both of proof of negligence and of privity of contract under the traditional common law. In addition, Part II of the Act empowers the Secretary of State to make regulations for the purpose of securing that goods are safe and contravention of those regulations constitutes a criminal offence. For details, see *Chitty on Contract*, *op. cit.*, (footnote 55, *supra*), para 41-099 *et seq*.

almost totally ignorant about the significance of such crucial components as CPU or RAM (which is information buyers familiar with computers need for assessing the offered price), the price he decides to accept at the time of purchase is entirely subjective and, for him, is acceptable in terms of the computer's ability to assist in the production of his thesis without problems. As long as there appears after the purchase no defect disrupting the machine's ability as such, it is inconceivable to say that his expectation at the time of purchase has not been met.[78] Notwithstanding that those with sufficient knowledge of computer may find that price too high and expect a computer at that price to be equipped with a faster processing unit (CPU) or bigger memory (RAM), there is no reason for allowing a third party's evaluation to affect the subjective judgment of the buyer at the time of purchase. Indeed, the argument based on the "subjective judgment" and "realisation of expectation" also explains why the mere fact that the buyer did not know that lower prices were available in the market cannot be a basis for excusing him from paying the price he agreed to pay for the goods or services.[79] In this regard, there appears an argument that permitting abnormal prices may be harmful to society in that the fixing of excessive prices will dissuade general consumers from contracting. Consumers, this argument goes, who are unsure

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[78] "Reasonable expectation" has been implored in numerous writings to be employed as a criterion of fairness: see for example Friedrich Kessler, "*Contract of Adhesion—Some Thoughts About Freedom of Contract*", (1943) Col. L.R. 629 at 637; David W. Slawson, "*Standard Form Contracts and Democratic Control of Lawmaking Power*", (1971) 84 Harv. L.R. 529 at 544 where he addresses that unfair terms in standard form contracts are inconsistent with the recipient's reasonable expectation; Barry J. Reiter, "*The Control of Contract Power*", (1981) 1 O.J.L.S. 347 at 360; Robert A. Hillman, "*Debunking Some Myths About Unconscionability: A New Framework ForU.C.C Section 2-302*", (1981) 67 Corn. L.R. 1 at 13 *et seq*. But see Chapter 6, pp. 334-336, *infra*.

[79] For the view that ignorance of better prices available in the market can afford a ground for relief, see, for example, Gordley, "*Inequality in Exchange*", *op. cit.*, (footnote 20, *supra*), at 1618-1619 at which he claims that the decision to have the best price available in the market is not subjective but found in all buyers irrespective of whether they deliberate to find it out; and enforcing the contract at the price closest to the market price is just putting him in the same position as any two parties trading on a market with a definite price. Kornhauser also implores intervention in prices when buyers find out after purchase that the goods are available elsewhere at lower prices. He argues that although the price paid by the buyer at the time of purchase is an equilibrium price in the sense that it is the product of the interaction of the price-setter and the price-taker, it is the wrong price in the sense that it differs from other competitive prices: see Lewis A. Kornhauser, "*Unconscionability in Standard Forms*", (1976) 74 Cal. L.R. 1151, at 1172. The same argument is presented in Melvin Aron Eisenberg, "*The Bargain Principle And Its Limits*", (1982) 95 Harv. L.R. 741, at 778-785, Buckley, "*Three Theories of Substantive Fairness*", (1990) 19 Hofstra L.R. 33 and Smith A. Stephen, "*In Defence of Substantive Fairness*", (1996) 112 L.Q.R. 138 (see also footnote 150, *infra*). These arguments cannot be accepted as being right here.

of the normal price and unable to research market prices (when such a practice is too costly) will hesitate to buy. On this basis, it is claimed that the law should refuse to enforce an exorbitant price. However, the credibility of this argument is apparently in doubt as long as empirical evidence suggests that most consumers are not daunted from purchasing goods or services in the market notwithstanding their ignorance of normal prices.

As for the class of buyers who anticipate the goods to be of any particular specifications and intend the price to be for that special quality, buyers of this class would usually be professional or skilled customers who are well capable of thorough inspection and judgment of such goods. Miscalculation of price by those buyers in this respect is, therefore, not common. Often, they make their intended quality and speculations known to the sellers. Thus, if the price paid does not agree with the quality obtained, these consumers are provided with sufficient remedies under the existing law—they can either bring an action against the seller for breach of contract if the contract was made on an expressly specified condition that the goods were to be of the required quality or speculations, or for breach of an implied condition under what is equivalent to section 14(3) of the English Sale of Goods Act 1979 (which requires that where the buyer makes known to the seller any particular purpose for which he intends to buy the goods, the goods must be reasonably fit for that purpose), or sue for misrepresentation if, during the inquiry, the seller misrepresented the facts relating to the quality or specifications of the goods. The same analysis also applies to the context of *services*. Services are intangible and the price is normally paid for a reasonable or otherwise specified level of quality. If the service is not rendered to this level, the buyer can simply resort to an action for breach of contract.

Given all this, the conclusion can be reached that there is no justification to let a contracting party have the price rectified on the mere ground of his ignorance of, *without more*, the quality or specifications of the goods or services, or the availability of lower prices in the alternative sources of supply. A general rule for controlling contract terms cannot be proposed on the basis of this type of ignorance. The phrase "without more" above is intended to be the meaningful qualification attached to these propositions. In some cases, ignorance of price is not merely connected with ignorance

of the quality or cheaper prices available in the market. It may be intimately tied to the lack of knowledge or understanding of *the total price charged itself*. This is particularly the case when the total price consists of various charges and the calculation of the total price is specified under the terms which are too complex for the buyer to understand, as once really occurred in the American case of *American Home Improvement, Inc.* v. *MacIver* [80] which will be discussed in Chapter 4. In such a case, the justification for the rectification of the price lies not in the quality or cheaper sources of supply but in the ignorance of the implications of the terms of the contract, the issue which will now be turned to.[81]

5.2 Ignorance Relating to the Implications of Contractual Terms

5.2.1 Overview of Justifications for Scrutinising Terms

Rather, ignorance which can provide the best and most plausible justification for introducing a general rule empowering the courts to correct an unjust result of a contract term is the kind of ignorance found in the case in which a contracting party fails to be aware of the implications of terms contained in a written contract and has apparently consented to them without his true consent. Apart from the instance where

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[80] (1964) 201 A.2d. 886.

[81] Collins, in *op. cit.* (footnote 29, *supra*), pp. 262-263, concedes, based on his "social market" concept (see footnote 226, *infra*) that the courts should rectify unfair prices and, in so doing, set a fair price by reference to the "market transference" technique which involves the measuring of the contract price against the market price—a transference of the contract price from one market (aberrational market) to another (ordinary market). The price charged by a door-to-door salesman, for example, may be unfair when compared to the ordinary retail value. In this connection, Collins adverts to *Toker* v. *Westerman* (1970) 274 A.2d. 78, which is also a case in the United States, to illustrate the judicial application of this technique to rectify unfair contract price. In sum, Collins asserts that mere excessive or aberrant price paid as a result of the ignorance of much lower prices available in the ordinary market is contrary to the "underlying conception of unfairness contained in the modern law": see *ibid.*, p. 271. This assertion seems dubious. It will be demonstrated in Chapter 4 that most courts in the United States have not meddled with an excessive price on such an alleged ground. *Token*'s case above can be criticised as incorrect and inconsistent with the underlying principle of § 2-302 of the U.C.C. Generally, the courts in the United States have held a contract price unconscionable only when it appears *either* that one party took advantage of circumstances of weakness of the other *or* that the aggrieved party failed to understand the contract term which sets out the computation of the total price of the contract.

the contractual terms are not conspicuous to the other party[82] or where that other party does not have an opportunity to ascertain the terms in the contract, the language of the terms and conditions in the contract may be far beyond the contracting party's comprehension. Sets of complicated and harsh terms are very frequently found in standard-form contracts. In this connection, it is *not* to raise any objections to the *use* of standard forms and neither is it submitted that a contract concluded in this fashion is challengeable merely because it is a one-sided contract. It is undeniable that the terms of this type of contracts are unilaterally fixed and the other contracting party is deprived of the right to co-determine the terms—he can just take it or leave it. But, it is now almost universally recognised that the advantage of the use of standard forms is the transaction-cost reduction. To negotiate each contract with each individual and draft its terms on a contract-by-contract basis is too costly and this dramatic escalation of transaction costs can simply be avoided by the use of standard forms for all customers. Once transaction costs are reduced, the contract price is lower. It is not sensible to insist, particularly in the context of consumer transactions, upon the right of co-determination and challenge standard-form contracts on the ground of their conclusion on a take-it-or-leave-it basis or on the impersonality of the market.[83]

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[82] The incidence of small print or hidden terms is representative of this class. It might be felt at first sight that the common law doctrine of "reasonable notice" has provided a solution to this problem. However, it will be shown below that the English common law rule remains insufficient: see p. 53, *infra*.

[83] Some early critics whose work criticised standardised contracts seem to recognise the cost-reduction advantage and necessity of standard forms but their attempts to suggest the scrutiny of the terms contained in such contracts appear to rest principally upon the lack of co-determination of terms between the parties. See for example, Karl N. Llewellyn, "*What Price Contract?*", (1931) 40 Yale L.J. 704 at 731, 732 where "lop-sidedness" of standard form contracts is viewed as pressing to the point where contract may mean rather fierce; Kessler, "*Contracts of Adhesion—Some Thoughts About Freedom of Contract*", *op. cit.* (footnote 78, *supra*), at 640 at which the "one-sided privilege" of adhesion contracts users is thought of as monopoly and the deprivation of consent of the other contracting parties. This line of arguments is untenable. Slawson views a standard-form contract as no contract since it does not represent democratic consent of the recipient of the form in the sense that it is merely delivered to him and contains unfair terms inconsistent with his reasonable expectation: see "*Standard Form Contracts and Democratic Control of Lawmaking Power*", *op. cit.* (footnote 78, *supra*), at 530, 541, 544. In saying this, Slawson does not, it must be noted, attack unfair terms on the ground of lack of co-determination. Slawson is merely concerned with the recipients' ignorance or lack of understanding of terms. This is manifest from his further elaboration that if the forms are read and understood, they are contracts: see *ibid*, at 545.

In England, once Lord Diplock, in *Macaulay's case*,[84] considered the use of a standard-form contract as the exploitation of general market and invalidated its terms, *inter alia*, on this ground,[85] his Lordship's judgment has raised much criticism and been viewed as incorrect. For example, Trebilcock, in strongly denying that the take-it-or-leave-it basis can be a sufficient reason for contesting terms in a standard-form contract, has pointed out that notwithstanding the one-sidedness of a standard-form contract the other party may, at the time of contracting, still have had a workably competitive range of alternative sources of supply in the market, so that the court should have taken this into account.[86] The same view has been expressed by Forte.[87] Indeed, the incorrect perception of standard-form contracts is also particularly

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[84] [1974] 3 All E.R 616. The facts of this case have been stated earlier at p. 28, *supra*.

[85] In this connection, his Lordship said:

> "It is the result of the *concentration of particular kinds of business* in relatively few hands. The ticket cases in the 19th century provide what are probably first example. The terms of this kind of standard form contracts *have not been the subject of negotiation between the parties to it*, or approved by any organisation representing the interests of the weaker party. They have been dictated by that party whose bargaining power, either exercised alone or in conjunction with others producing similar goods and services, enables him to say: 'If you want this goods or services at all, these are the only terms on which they are obtainable. *Take it or leave it.*' ": see [1974] 3 All E.R. 616, at 624 (italics added).

[86] M.J. Trebilcock, "*The Doctrine of Inequality of Bargaining Power: Post-Benthamite Economics in the House of Lords*", (1976) 26 U. of Toronto L.J. 359, at 364-366; "*An Economic Approach to the Doctrine of Unconscionability*", *op. cit.*, (footnote 44, *supra*), p. 379 at 399; M.J. Trebilcock and D.N. Dewees, "*Judicial Control of Standard Form Contracts*", in *The Economic Approach to Law*, Burrows and Veljanovski ed., (Butterworths, 1981), Chap. 4, p. 93 at 99. See also Hugh Beale, "*Unfair Contract in Britain and Europe*", [1989] Current Legal Problem 197, in particular at 203-204 (viewing that there is no correlation between market concentration and the use of standard forms).

[87] A.D.M. Forte, "*Unfair Contract Terms: Evaluating An EEC Perspective*", (1985) L.M.C.L.Q. 482, at 487-489 (agreeing with Trebilcock). See also Wooldridge, "*Inequality of Bargaining Power in Contract*", [1977] J.B.L. 312. The most recent article by John Swan, "*Party Autonomy and Judicial Intervention: The Impact of Fairness in Commercial Contracts*", (1994) 7 J.C.L. 1, is also of particular value. This article raises questions as to the accuracy of the unreported decision of the Court of Appeal in *Zang Tumb Tuum Records Ltd.* v. *Holly*. The disputed term of the contract in this case was similar to that in *Macaulay's case* except that the contract in the former was concluded between a group of musicians and a recording and publishing company. In declaring the term unreasonable, the court also gave much weight to the fact that the deal was offered on a 'take-it-or-leave-it' basis and the recording company refused to alter any term as requested by the solicitor of the musicians' group. Swan argues that the court's concern over the issue was misplaced and that no economic theory supports the judgment. See also S.M. Waddams, "*Commentary on 'The Impact of Fairness in Commercial Contracts'*", (1994) 7 J.C.L. 28 for commentary on Swan's discussion above.

reflected in the speech of Lord Reid in *Suisse Atlantique Société d'Armement Maritime S.A.* v. *N.V. Rotterdamsche Kolen Centrale*.[88]

What should particularly receive close attention is, therefore, not the *use* of standard forms but any, or the combination, of the following facts relating to the terms contained in such contracts: the inconspicuousness of terms, the absence on the part of the non-drafting party of a practical opportunity to ascertain the terms, and the incomprehensibility of contract terms. The first two point to the lack of knowledge of the *existence* of contract terms whereas the other directly depicts the lack of knowledge of the *implications (meaning)* of the terms concerned. However, given that the lack of knowledge of the existence of any particular contract term will prevent the awareness of its implications in the first place, it can therefore be said that all these three facts above concern the lack of knowledge of the *implications* of contract terms; (and it is based upon this logic that expositions in this section of the thesis are made under the heading "Ignorance Relating to the Implications of Contractual Terms"). The last-mentioned fact may stand as the most common instance. Complex terms are usually the product of legal drafting techniques which involve the application of legalistic language and wordings not understood by layman consumers, often coupled with complex organisation of the document. The lack of understanding of implications of such terms precludes consumers from refusing to enter into the contract at the outset and, once they subsequently have full knowledge, can result in their "unfair surprise" at the terms' drastic effects by which they would never have agreed to be bound but for their ignorance. Take as an example the so-called "*add-on*" clauses contained in a standard contract of sale in an American case of *Williams* v. *Walker-Thomas Furniture Co.* [89] which provided that payment was to be made in instalments; that goods previously purchased from the seller would serve as security for the current

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[88] [1967] 1 A.C. 361, at 406 where his Lordship said: "the consumer has no time to read them [standard-form contracts]; and if he did read them he would probably not understand them. And if he did understand and object to any of them, *he would generally be told he could take it or leave it*" (italics added). See also Lord Denning M.R.'s view in *Levison* v. *Patent Steam Cleaning Co. Ltd.* [1978] 1 Q.B. 69 (C.A.), at 79 ("an exemption clause "should not be given effect if it is unreasonable particularly in standard form contracts where there is inequality of bargaining power").

[89] (1965) 350 F.2d. 445.

purchase and the seller could at his own discretion apply each instalment payment made with respect to each item purchased against all outstanding balances; and that the seller was entitled to repossess all the goods in the event of a default in the payment of any instalment. One of these clauses provided as follows:

> "The amount of each periodical installment payment to be made by purchaser to the Company under this present lease shall be inclusive of and not in addition to the amount of each installment to be made by purchaser under such prior leases, bills or accounts; and all payments now and hereafter made by purchaser shall be credited *pro rata* on all outstanding leases, bills and accounts due to the Company by purchaser at the time each such payment is made."

The drastic effect of this complicated provision, as indicated by Skelly Wright J., was to keep a balance due on every item purchased until the balance due on all items, whenever purchased, was liquidated and each new item purchased automatically became subject to a security interest arising out of the previous dealings.[90] If the buyer previously purchased a refrigerator on an instalment plan requiring 24 monthly payments and then, after having made 23 instalment payments, purchased a television also on an instalment basis, the seller would, when the last instalment payment for the refrigerator was made, decide to apply part of it to the refrigerator and the remainder to the television, with the result that the debt on the refrigerator has not yet been discharged and thus when the buyer now makes even a minor default on just one instalment payment for the television the seller decides to repossess both the refrigerator and the television. It is hard to imagine that customers of moderate financial means would have accepted such clauses if they had been fully aware of the dreadful effect. The complication of the wordings and organisation of the clause simply prevented their full comprehension.

Epstein, in his article[91] written in opposition to the doctrine of unconscionability as contained in section § 2-302 of the United States' Uniform Commercial Code (which, as will be explained in Chapter 4, has stood as the most important statutory provision empowering the courts to scrutinise unconscionable

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[90] (1965) 350 F.2d. 445, at 447.

[91] Epstein, "*Unconscionability: A Critical Reappraisal*", (1975) 18 J. Law and Econs 295.

contract terms), argues that unconscionable clauses should not be questioned. Apart from his contention that it is difficult to know what principles identify the "just" term, his argument principally rests upon the belief that most clauses used in commercial transactions are in the interest of both parties to the transaction. He examines a few typical clauses including the "add-on" clauses discussed above. Epstein claims that the "add-on" clauses benefit both parties and advocates that one of the major risks to the seller of durables is that the goods sold will lose value faster than the purchase price is paid off and in the event that the seller has to repossess the goods from his defaulting party he runs the risk that repossession will still leave him with a loss on the transaction as a whole. One way of protection is to require a larger cash down-payment by the buyer, which many buyers do not want. Buyers would prefer to offer previously purchased goods as collateral instead of lodging a larger cash down-payment. Epstein's claim that such clauses are *always* in the interest of both parties (for the buyer, the avoidance of a larger cash down-payment; for the seller, the firm security interest) is seriously arguable since it is true only in the case where the buyer, at the time of the contract, fully understood the implications of such terms and acceded to them with an eye to avoiding the requirement of a larger cash down-payment which he can never afford or never wants to lodge. For this class of buyers, accepting these unconscionable clauses may be the only way they can obtain expensive goods to their satisfaction, in which case the ensuing harshness of the clauses falls within the category of substantive unfairness *per se*, in respect of which intervention is unjustifiable,[92] as has been previously discussed. But, in contrast, the other class of buyers, those who are able to afford that larger sum as a cash down-payment and prefer to lodge it in anticipation of the immediate discharge of the debt upon the last instalment, will be most unlikely to accede to these clauses. Their consent to such clauses would be due to ignorance and could therefore be *apparent* rather than *true* consent which would not have been given had they been fully aware of the effect of the terms. Once fully

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[92] For other harsh clauses which represent mere substantive *per se*, see for example termination-at-will clause in a franchise agreement as explained by Benjamin Klein in "*Transaction Cost Determinats of "Unfair" Contract Arrangement*" in *Readings in the Economics of Contract Law*, Goldberg ed. (Cambridge University Press, 1989), Chap. 6.1, p. 142.

aware of the drastic consequence, these buyers are just "unfairly surprised".[93] (This analysis is also applicable even to the class of poor buyers who would never have preferred this drastic effect and would not have bought the goods if they had been aware of it.) It is noteworthy that on the facts in *Williams* v. *Walker* itself, the buyers did not understand the implications of such clauses and thus did not have a meaningful choice. The lack of a meaningful choice as a result of the failure to understand the clauses in the contract was invoked by Skelly Wright J. as the ground for invalidating them. The following passage is illuminant of this:[94]

> "In many cases the meaningfulness of the choice is negated by gross inequality of bargaining power. The manner in which the contract was entered is also relevant to this consideration. Did each party to the contract, considering his obvious education or lack of it, *have a reasonable opportunity to understand the terms of the contract*, or were the important terms hidden in a maze of fine print and minimized by deceptive sales practices? Ordinarily, one who signs an agreement without full knowledge of its terms *might* be held to assume the risk that he has entered a one-sided bargain. *But when a party of little bargaining power, and hence little real choice, signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that his consent was ever given to all the terms*. In such a case, the usual rule that the terms of the agreement are not to be questioned should be abandoned and the court should consider whether the terms of the contract are so unfair that enforcement should be withheld."

Another striking illustration of harsh clauses acceded to by consumers out of their ignorance can be found in the "waiver-of-defence" clauses which were declared unconscionable under § 2-302 and § 9-206 of the U.S. U.C.C. by the court in another American case of *Unico* v. *Owen*.[95] These clauses were tailored to the effect that where the seller who sold the goods on an instalment payment basis sold (by way of assignment) his rights under the contract to a third party the buyer's liabilities to the assignee should be absolute and not affected by any default of the seller. That is to say,

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[93] The term "unfair surprise" has rarely been used in England. However, it can be found at least in *Evans* v. *Llewellin* (1787) 1 Cox. Eq. Cas. 333, 29 E.R. 1191 where Kenyon MR. spoke, in the context of a bargain with a poor and ignorant person, of a bargain being "*taken by surprise*". In the English context, a good illustration of unfair surprise can be seen from the terms considered in *Interfoto Picture Library Ltd.* v. *Stiletto Visual Programmes Ltd.* [1988] All E.R. 348 (terms fixing the holding fee of £5 per day for late returned transparencies).

[94] (1965) 350 F.2d. 445, at 449-450 (italics added).

[95] (1967) 232 A.2d. 405.

the buyer was required to continue to pay his instalments although the seller did not even deliver the goods under the contract, or breached his warranty obligations. The drastic effect of this clause was self-evident.[96] The reason for the inclusion of this sort of clause into the contract was that the seller had an intimate relationship with a finance company and had a mutual arrangement for assigning the seller's rights to this finance company, which in this case brought an action against the buyer for the payment. Since the assignee in the course of this transaction was normally not considered by law as a holder in due course, it was not entitled to take the assigned rights free of defences the buyer may have had against the seller. The clauses were thus intended to make the assignee the equivalent of the holder in due course.

Epstein, once again, argued that there is no principled justification for the judicial or legislative prohibition of these clauses since their uses were in the interest of both parties. "Suppose", he said,[97] "the seller says to the buyer of his goods 'If you wish to buy them on time, you must take out a bank loan for credit.' Under that arrangement, the buyer remains unconditionally liable on his note to the bank even if his seller is in breach of his warranty obligation. If that arrangement is not unconscionable, why should it be unconscionable for the buyer to have no remedy against the lender because he happens to be chosen by the seller instead of the buyer?" To Epstein, the main advantage to both parties of the seller's arrangement is the reduction of the transaction costs. Prohibition of this arrangement will raise transaction costs since buyers will have to approach the bank themselves and yet remain unconditionally liable. Again, Epstein's argument is over-inclusive since it can be undeniably true only in respect of a class of buyers who intend to finance their

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[96] One such clause was complicatedly drafted to read as follows:

> "Buyer hereby acknowledges notice that this contract may be assigned and that assignees will rely upon the agreements contained in this paragraph, and agrees that the liabilities of the Buyer to any assignee shall be immediate and absolute and not affected by any default whatsoever of the Seller signing this contract; and in order to induce assignees to purchase this contract, the Buyer further agrees not to set up any claim against such Seller as a defense, counterclaim or offset to any action by any assignee for the unpaid balance of the purchase price or for possession of the property."

[97] *Op. cit.*, (see footnote 91, *supra*), at 309.

purchase in that manner and fully appreciate that the harsh effect of the clause yields no difference from a loan from a bank itself, which, again, is the case of mere substantive unfairness *per se*. However, the buyers who intend to pay in instalments simply out of their own pockets will hardly seem to agree with the condition that if the sellers simply breach their obligation by non-delivery or otherwise buyers cannot withhold their remaining instalment payments. On meticulous scrutiny of the facts in *Unico* v. *Owen* itself, the defendant buyers never intended to seek the financing of their purchase of the goods (stereo phonic record albums). The clauses were contained in Exhibit A printed on the reverse side of a form which was presented to the buyers by the seller's representative for the buyers' signatures. The clauses concerning the arranged assignment were in very fine print. The buyers neither had notice of the clauses nor had their significance explained to them. Their understanding was only that the stereo albums were to be delivered to them every specified period and they were to make the specified monthly payments from their own pockets without any other sorts of financing being sought by them. It was against these facts that the court declared the clauses unconscionable.[98] Once again, consumer ignorance affords the ground for rectifying the harshness.[99]

As most day-to-day consumer transactions are nowadays made on the basis of standard-forms with complex and unintelligible terms, market imperfection in the form of ignorance or failure to perceive the implications of contractual terms is no longer rare as the liberal theorists once believed. On the contrary, it is, as one can agree with Atiyah, almost totally ubiquitous.[100] For this reason, it is desirable to have a general

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[98] 232 A.2d. 405, at 417.

[99] By this analysis, it can be reiterated here that Epstein's view that "the doctrine of unconscionability, the application of which allows the courts to act as roving commissions to set aside those arrangements whose terms they find objectionable, is undesirable and serves only to undercut the private right of contract in a manner that is apt to do more social harm than good" (*op. cit.*, footnote 91, *supra*, at 305) is tenable only in the context of intervention in substantive unfairness *per se* and will be erroneous if extended to the case of the correction of harsh terms agreed as a result of consumer ignorance: informational asymmetry.

[100] However, a criticism can be addressed with regard to Atiyah's advocation. When Atiyah speaks of the ubiquity of market failures and attempts to put forward the general requirement of fairness in contracts on this footing, his argument is much directed at monopolies and consumers' ignorance of quality or components of goods: see Atiyah, "*The Liberal Theory of Contract*" in his *Essays on*

rule allowing the courts to scrutinise the terms and rectify their unfair results in contracts in general.

Trebilcock and Dewees have suggested that the role of the courts in policing terms in standard-form contracts should be rather narrow and they have asserted some qualifications to be noted on the control policy. First, the role of the marginal consumer must be reckoned with. It may be that there are enough consumers who are sensitive to the content of the terms to bring effective pressures to bear on the term-setters (for instance, by threatening to initiate legal proceedings or to withdraw future dealing or otherwise undermine their credibility with other potential customers) to modify terms in a more acceptable way. It is thus, their argument goes, conceivable that if only ten per cent of the buyers scrupulously studied all the terms before contracting this might create effective pressures on the supplier to adjust the terms, which will consequently be beneficial to all potential customers.[101] Although this caveat is appreciated, it should not be forgotten that empirically consumers tend to study only the price they have to pay for the goods or services. It is unlikely that the number of the marginal (sophisticated) consumers who scrupulously examine all terms in the contract will be sufficient to create pressures on firms to the benefit of all other consumers in the sense above. Another caveat noted by these writers is that on some occasions the information problem does not lie in working out what particular terms mean but in applying information to the parties' personal circumstances, as can be seen in an insurance contract where the party may perfectly understand how all terms allocate risks but may have difficulty in assessing the likelihood of the risks being materialised.[102] The response to this contention is that this type of incident is found merely in some, not all, instances. The more common information problem is with the

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Contract, *op. cit.*, (footnote 5, *supra*), Essay 6, p. 121 at 134 and "*Contract and Fair Exchange*" in *ibid.*, Essay 11, p. 329 at 351-352. We have previously explained that this type of ignorance can hardly gain ground for general intervention. It is submitted, therefore, that the real argument should centre on the ubiquity of ignorance about the implications of contractual terms.

[101] Trebilcock and Dewees, "*Judicial Control of Standard Form Contracts*", *op. cit.*, (footnote 86, *supra*), p. 105. The same line of argument has also been addressed in Trebilcock, "*An Economic Approach to the Doctrine of Unconscionability*", *op. cit.*, (footnote 44, *supra*).

[102] *Ibid.*, p. 115. (Also addressed in *An Economic Approach to the Doctrine of Unconscionability*, *ibid.*, pp. 416-417.

inability to perceive the implications of contract terms, so that the proposed notion of having a general rule to undo the terms can maintain its merit (and it is noted that in such a case where the type of information problem in relation to which Trebilcock's and Dewees' caveat is addressed is present, the proposal as made in this thesis for policing contractual terms does not extend to it, for we merely suggest that the control be conducted on the basis of term-oriented ignorance).

Schwartz and Wilde have advocated their argument which is much similar to Trebilicock's and Dewees' view. They argue that although some consumers in the market do not search in the market before buying and, as a result, pay supracompetitive prices, enough searchers do exist. Especially, comparison shopping nowadays seems convenient when price advertising is common.[103] The presence of at least some consumer search in a market creates the possibility of what they call "pecuniary externality" by which they mean the searchers sometimes protect non-searchers from overreaching firms. It is usually too expensive for firms to distinguish amongst extensive, moderate and non-searchers and it would often be too costly to draft different contracts for different groups. If a sufficient number of searchers exists, firms have incentives to offer the same terms to all including non-searchers. This will generate optimal prices and terms for all consumers. Given all this, Schwartz and Wilde conclude that no information problem exists.[104] Again, it is enough to be said, in an attack on this argument, that searcher-consumers are merely price-conscious, not term-conscious. Their searching is very unlikely to be generally undertaken in the content of the terms.[105] Apparently, Schwartz and Wilde are well aware of this when

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[103] In the UK context, a number of public enactments assist consumers in conducting price comparison. See, for example, Part III of the Consumer Protection Act 1987 (prohibiting a misleading price indication, especially, misleading "bargain offers") and statutory instruments issued thereunder; Weights and Measurements Act 1985; Trade Description Act 1968 and all legislation controlling the advertising of goods. For details, see *Chitty on Contract*, *op. cit.*, (footnote 55, *supra*), paras 41-110 and 41-112.

[104] Alan Schwartz and Louis L. Wilde, *"Intervening in Markets on the Basis of Imperfect Information: A Legal and Economic Analysis"*, (1979) 127 U. of Penn. L.R. 630, at 656, 638.

[105] See a concrete example in Melvin Aron Eisenberg, *"The Limits of Cognition and the Limits of Contract"*, (1995) 47 Stanford L.R. 211 at 244 where he points out that consumers who shop for checking accounts (current accounts) will not focus on such terms as those detailing the consequences of failing to detect and promptly report an error in the monthly statement, or the penalty for

they clearly state that the equation of price consciousness with term consciousness is imperfect and, given this, firms are more likely to offer less favourable terms to consumers.[106] Nonetheless, Schwartz and Wilde argue that despite this imperfect information, intervention by means of attacking the term itself is not appropriate and can be merely a solution second best to the requirement of disclosure. Their reasons are threefold. First, policing the terms is unlikely to be effective since the firms can maintain exploitation by switching to other terms. Next, such intervention would deprive consumers of the chance of taking advantage of lower prices offered on less generous terms. Lastly, it would sometimes happen that under the force of high competition the industry competitively offers generous terms to the public.[107] These grounds are all weak. The counter-argument to the first ground can be that any shift to other new terms is immaterial if those new terms are to be equally scrutinised by the courts as long as a general rule giving them such jurisdiction is introduced to be of general application. The second ground is true, as has frequently been reiterated, only in relation to the control of substantive unfairness *per se*, not in the context where consumer ignorance exists. As regards the third argument, it cannot be taken for granted that traders will, even under the influence of competition, avoid offering bad deals to consumers; and it is when things do not turn out that way that the general rule is called for in order to rescue the aggrieved party. Finally, it must also be said that the contention that the ignorance problem can be best solved by the "disclosure" requirement is too simplistic. The discussion of this requirement in the light of the control of unfair terms in contracts is deferred to a later section of this chapter.[108]

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overdrawing the account. Once some banks offer high interest rates but low-quality terms, competition will force other banks to contract in the same fashion. This is often called "the-market-for-lemons phenomenon". See also Kornhauser, "*Unconscionability in Standard Forms*", *op. cit.*, (footnote 79, *supra*), at 1168-1169 where he points out, agreeing with Leff's "*Contract as Things*" (1970) 19 American Univ. L.R. 131, that complex terms in standard form contract can be viewed as "things" or ordinary goods sold in the market whose quality people cannot determine and when consumers cannot distinguish good from bad terms, the sellers are inclined to produce low-quality terms to increase their profits.

[106] *Op. cit.*, (footnote 104, *supra*), p. 660.

[107] *Ibid.*, p. 667.

[108] See p. 98 *et seq*, *infra*.

It is noted that the discussions in an attempt to justify the introduction of a general rule to control contract terms have so far focused on standard-form contracts. This is simply because in most cases contract terms which yield the informational problem in all senses previously explained are those terms contained in standard contracts. However, it must not be taken for granted that this ignorance problem is limited to the standard-form contract instance. A contract between two parties may merely be a written contract made on an individual basis without the element of standardisation; and this contract may well contain inconspicuous or incomprehensible clauses like those normally found in standard-form contracts.[109] For this reason, a general rule to be introduced for empowering the courts to undo contract terms on the ground of ignorance should not have its application limited to standard-form contracts. It would seem more conceptually accurate for such a rule to be applicable to general *written* contracts, regardless of whether they are standard-form contracts or not.[110] However, it will be shown below that its application should not be extended to a written contract made between two non-business parties or a written contract made by the relief-seeking party in the course of his trade or business. The reason why this proposed general rule should not apply to oral contracts will also be described.[111]

5.2.2 Insufficiency of Protection by English Law

As previously mentioned, market imperfection in the form of ignorance relating to the implications of contract terms can be categorised into two main classes, viz, (1) the lack of knowledge of the *existence* of the terms and (2) the lack of knowledge of the *meaning* of the terms. The first class can further be subdivided into two categories:

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[109] In non-standardised written contracts, although the lack of opportunity to ascertain the relevant terms can possibly be found, its occurrence may seem rare.

[110] The restriction of control to standard contracts is found in the Israeli Standard Contracts Law 1964 and the German Act Concerning the Regulation of the Law of Standard Contract Terms 1976 (*Gesetz zur Regelung des Rechts der Allgemeinen Geschäftsbedingungen: AGB-Gesetz*). Useful discussion on the Israeli law above can be found in the references cited at footnote 93 of Chapter 5, *infra*. As for the German Act, see Otto Sandrock, "*The Standard Terms Act 1976 of West Germany*", (1978) 26 Am. J. Com. L. 551; Wolfgang Freiherr von Marschall, "*The New German Law on Standard Contract Terms*", [1979] L.M.C.L.Q. 279.

[111] See pp. 62, 63 and 81, *infra*.

(a) where unawareness of the existence of a contract term is due to the *inconspicuousness* of the term and (b) where it is due to the *absence of a practical opportunity to ascertain* the terms. In none of these classes has English law afforded contracting parties sufficient protection against unfair terms.

(a) Inconspicuousness

With regard to an inconspicuous term which at the outset prevents a party from knowing that it exists and its substance runs to his detriment, the common law has established the principle that the terms, in order to be an integral part of the contract and bind the party against whom they are invoked, must have reasonably been brought to the attention of that party at the time the contract was made. This so-called "reasonable notice" doctrine also requires that the more unreasonable or unusual a term appears the greater degree of notice is required. The doctrine has been established and followed by a long line of authority[112] and, following *Interfoto Picture Library Ltd.* v. *Stiletto Visual Programme Ltd.*,[113] it applies not only to exclusion clauses but is of general application. At first glimpse, the doctrine seems well to alleviate the problem of inconspicuous terms, particularly small print or hidden mass, prevalent in written contracts. However, on perusal, the protective measure embodied in the "reasonable notice" requirement in relation to inconspicuousness has appeared inadequate since although its application is not limited to exclusion clauses it does not apply to the instance in which a contract is signed by the party purporting to plead his unawareness of particular terms contained therein. On the authority of *L'Estrange* v. *F. Graucob Ltd.*,[114] if the document is signed, the party signing it is immediately taken to have the notice of its terms, irrespective of whether he has read them or whether the terms are

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[112] See, for example, *Parker* v. *South Eastern Rly Co.* (1877) 36 L.T.R. 540; *Olley* v. *Marlborough Court Ltd.* [1949] 1 All E.R. 127; *J. Spurling Ltd.* v. *Bradshaw* [1956] 1 W.L.R. 461; *Thornton* v. *Shoes Lane Parking Ltd.* [1971] 1 All E.R. 686. Since *Parker's case* is the leading case, the reasonable notice rule is sometimes called the "Parker rule": see Elizabeth Macdonald, "*The Duty to Give Notice of Unusual Contract Terms*", [1988] J.B.L 375, at 379.

[113] [1988] 1 All E.R. 127.

[114] [1934] 2 K.B. 394. See also *Curtis* v. *Chemical Cleaning and Dyeing Co.* [1951] 1 All E.R. 631. For the contemporary position in the Continental law, see O. Prausnitz, *The Standardization of Commercial Contracts in English and Continental Law*, (Sweet & Maxwell, 1937), pp. 43-45.

in small print or located in a place not easily seen. This restriction runs counter to the reality in the present world of commerce in which most written contracts require signatures by both contracting parties or their agents. Indeed, the distinction between unsigned and signed documents in relation to the requirement of reasonable notice appears to be of too little sense.

It is noted that the notion that a signed contract should receive special treatment is not pursued in some common law jurisdictions, in which case it may seem unnecessary that a legislative general rule by which to subject contract terms to judicial scrutiny embrace inconspicuousness as a ground of litigation, for resort can simply be had of relief existing at common law. The application of such a legislative rule to "inconspicuousness" will be no more than a restatement of the common law position, as is found in § 2-302 of the United States U.C.C.[115] However, in the context of England, as long as the doctrine announced in *L'Estrange* v. *Graucob* is not explicitly overruled and the inconspicuousness problem thus remains insufficiently tackled with the aid of common law, there is a strong case for the legislature to intervene.

It might be argued that the use by one party of inconspicuous terms in the contract with the other is the advantage-taking of the circumstances of weakness of that other party and thus the equitable doctrine of unconscionability (dealing with "poor and ignorant persons") can be of assistance. This equitable doctrine will be discussed below in the light of the "incomprehensibility" of contract terms.[116] It will be found from the same analysis there that the equitable doctrine relating to "poor and ignorant persons" is unhelpful to the "inconspicuousness" scenario since the type of "ignorance" which is perceived to be capable of triggering the operation of the doctrine seems to have been restricted to the ignorance of the "true value" of the property in the transaction concerned. Even when equity is, on a good day, extended to be applicable to a wider range of circumstances including the ignorance of the existence of contractual terms now being considered, granting that *all* cases involving

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[115] See Chapter 4, *infra*.

[116] See p. 58 *et seq*, *infra*.

"inconspicuousness" can fall under the supervisory teeth of equity will run counter to its conceptual stance. Inconspicuousness may not necessarily occur in the form of too small print or hidden mass of terms deliberately inserted in a contract to prevent notice by prospective customers. It also embraces the situation in which onerous or unusual terms are written in an ordinary type or appear in an ordinary place but without special warning by the *proferens* of their existence. In such a case, when the contract is not concluded on a personal basis (which is typically the case in the "firm-consumer" context), the element of advantage-taking may not be apparent and, as a result, to treat this situation as falling under the rule of equity is more uneasy than tenable.[117] It will be more plausible and expedient to treat all cases involving inconspicuousness under the legislative rule which allows judicial investigation of unfair results of contract terms.

(b) Lack of Opportunity to Ascertain Contract Terms

Moving to consider the scenario in which a contracting party does not have a practical opportunity of ascertaining the terms in the contract being made, one can see that the doctrine of reasonable notice above compels the courts to treat those terms as having reasonably been brought to his attention. Historically, the reasonable notice doctrine initially emerged in the context of "ticket" cases or the like cases in which special terms printed either on the reverse side of the ticket itself or in a separate document or separate notice which was referred to merely by a few words on that ticket were decided by the courts as having perfectly been incorporated into the contract.[118] It is found from the historical survey of case law that the original reason for the courts holding such manner of incorporation as effective *vis-à-vis* the other party is that, as clearly expounded by the court in the old case of *Van Toll* v. *The South*

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[117] *Cf.* the "consumer-consumer" scenario discussed at footnote 142, *infra*. This thesis grants that where a contract is made between two parties dealing with each other privately as consumers, the conclusion of the contract is *personalised*, with the result that if inconspicuousness is found in the form of an onerous term standing without special warning of its existence this personalisation will trigger the element of advantage-taking which will, in turn, bring the case under the equitable doctrine.

[118] See, for example, *Thompson* v. *London, Midland and Scottish Rly Co.* [1930] 1 K.B. 41, at 46.

Eastern Rly. Co.,[119] it already gives that other party *the means of ascertaining the clauses.*[120] This has also been clarified in the later case of *Parker* v. *The South Eastern Rly Co.*[121] where it was stated that the party who saw such clauses or such reference to other clauses must have known that there existed some special clauses to which they were to be subject and, knowing that, had to take the trouble to ascertain what the clauses were. Once the party agreed to be a party to a contract, even with harsh terms, he must be taken to have *either* ascertained such terms and expressly assented to them *or* chosen to be bound by the terms whatever they might be, without ascertaining them. This *ratio decidendi* is fraught with difficulties in the world of hasty transactions we are nowadays facing almost all the time. Although customers in hurried transactions may know that some special terms actually exist, the speedy nature of the transaction simply renders the ascertainment of the terms unfeasible so that the real knowledge of the terms is absent, with the immediate result that the knowledge of the implications of those terms is also prevented and consent to unfair results which the contract terms may produce is then more apparent than real. This reality has been, in fact, appreciated by the court in *Zunz* v. *The South Eastern Rly Co.*[122] where Cockburn C.J. thought that the principle based on the *objective* means of ascertainment was inappropriate but felt bound on the authorities to hold as such.[123]

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[119] (1862) 12 C.B. (N.S.) 75, 142 E.R. 1071

[120] (1862) 12 C.B. (N.S.) 75 at 84, 142 E.R. 1071 at 1074 per Erle C.J.

[121] (1877) 36 L.T.R. 540. For the views of Continental courts (before Parliament enacted special Acts), see O. Prausnitz, *op. cit.*, (footnote 114, *supra*), pp. 72-79.

[122] (1868) 4 L.R. Q.B. 539.

[123] Here, the Chief Justice said:

> "However hard it may appear in practice to hold a man liable by the terms and conditions which may be inserted in some small print upon the ticket, which he only gets at the last moment after he has paid his money, *and when nine times out of ten he is hustled out of the place at which he stands to get his ticket by the next comer*, ..., still we are bound on the authorities to hold, that when a man takes a ticket with conditions on it he must be presumed to know the contents of it, and must be bound by them": (1868) 4 L.R. Q.B. 539, at 544 (italics added).

See also Lord Denning M.R.'s view, in *Thornton* v. *Shoes Lane Parking Ltd.* [1971] 1 All. E.R. 686 at 689, on ticket cases: "No customer in a thousand ever read the conditions. If he had stopped to do so, he would have missed the train or the boat." Similarly, Megaw's L.J. commented, in *ibid.*, at 693: "it does not take much imagination to picture the indignation of the defendants [garage

Two observations can be brought out in relation to these "ticket" cases. First, the degree of notice was subsequently qualified in *J. Spurling Ltd.* v. *Bradshaw*[124] and *Thornton* v. *Shoes Lane Parking Ltd.*[125] to the effect that the greater notice is required of more unusual terms so that "red ink" rather than a simple reference may be needed to bring these terms to the other party's attention. Secondly, most harsh terms in ticket cases involve the exclusion of liability which is now already under scrutiny by the Unfair Contract Terms Act 1977. Notwithstanding these observations, the judicial enunciation regarding the "*objective* ascertainment" of contract terms has survived and has been equally applicable to general cases and general terms. The courts appear to have presumed the consumers' sufficient knowledge of the existence of unfair terms when they are, for example, in red ink or in bold-face, even though the consumers are practically subject to such a hasty nature of the transaction as to be unable to ascertain them. The imposition of this type of constructive knowledge is even more radical in the context of a signed contract. As mentioned earlier, once the document is signed, the signatory is immediately taken to have the notice of its terms, irrespective of whether he has an opportunity to read them or not. The speedy character which is frequently required of various transactions in modern markets but leads to the consumer's ultimate ignorance of unfair consequences produced by the terms in the contract in question has hardly been taken into account.[126] Thus, the contention that the "red ink"

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owners] if their potential customers, having taken their tickets and observed the reference therein to contractual conditions ..., were one after the other to get out of their cars, leaving the cars blocking the entrance to the garage, in order to search for, find and peruse the notices!."

[124] [1956] 1 W.L.R. 461 at 466 per Denning L.J. where he said: "some clauses.. need to be printed in red ink...with a red hand pointing to it before the notice could be held to be sufficient".

[125] [1971] 1 All. E.R. 686.

[126] As mentioned at footnote 88 *supra*, Lord Reid, in *Suisse Atlantique Société d'Armement Maritime S.A.* v. *N.V. Rotterdamsche Kolen Centrale* [1967] 1 A.C. 361 at 406, was concerned with the fact that consumers in standard form contracts had no time to read the contracts. However, his speech is no more than a dictum.

Cf. the German Standard Terms Act 1976 alluded to at footnote 110, *supra*. § 2 of the Act expressly requires both notice and a "reasonable opportunity to obtain the knowledge of the content of the contract term" in order that the term becomes a component part of the contract. However, the insertion of the latter requirement into the Act was merely intended to compel the *proferens* to make available to the non-drafting party the terms and conditions which are contained in a separate document but referred to by the main document: see Sandrock, *op. cit.*, (footnote 110, *supra*), at 559

rule is a logical development of the common law rule (in the sense of requiring such degree of notice as commensurate with the nature of the clause concerned instead of an ordinary level of notice)[127] cannot be equated with the sufficiency of the common law. Justification for introducing a new general rule empowering the courts to scrutinise and rectify unfair contractual terms is, therefore, explicable here.

(c) Incomprehensibility: Inability to Understand Contract Terms

Now, in the final case—the instance in which ignorance of the implications of contract terms directly emerges from the incomprehensibility of the terms concerned—English common law has never protected contracting parties against this type of ignorance. The equitable doctrine of "unconscionable bargains" which governs transactions made with the party described as a "poor and ignorant person" and sets aside the transaction when advantage has been taken of that party's poverty or ignorance is not of help here. Before this can be explained, it is felt that one remark should first be made in relation to this doctrine. Although the class of persons under the protection by this doctrine has almost always been described by the courts as "poor *and* ignorant persons",[128] the doctrine, in essence, does not require the protected persons to be *both* poor *and* ignorant. Taking advantage by one party of *either* poverty *or* ignorance of the other is sufficient to bring the transaction under the doctrine's operation. Historical surveys of cases reveal that the doctrine was created to provide remedy to expectant heirs who sold an estate that they expected to obtain by way of inheritance to the other party at a considerable undervalue when they were in a financial distress or ignorant of the true value of the property or who borrowed money with a promise to repay a considerably higher sum from such inheritance.[129] In many cases, the heirs were both in need of money and ignorant of the real value, as often

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and von Marschall, *op. cit.*, (footnote 110, *supra*), at 281. The legislator did not appear to contemplate the problem of transaction haste.

[127] Macdonald, *op. cit.*, (footnote 112, *supra*), at 382.

[128] See, in particular, *Fry* v. *Lane* (1888) Ch. D. 312, at 322.

[129] See Clark, *Inequality of Bargaining Power*, *op. cit.*, (footnote 4, *supra*), p. 1; M. Cope, *Duress, Undue Influence and Unconscientious Bargains*, (The Law Book Company: Sydney, 1985), p. 119 *et seq.*

occurred when a purchase was made from or a loan given to a young heir needing money to satisfy his extravagance.[130] But in many other cases, the heirs who acceded to such an undervalue or over-repayment were merely pressed by a financial difficulty alone[131] or were ignorant of the true price alone. Given this, it is evident that the genuine rationale of the doctrine was the prevention of an unfair advantage from being taken of merely *either* poverty *or* ignorance of the other party. When the doctrine was developed, in particular by the decision in *Fry* v. *Lane*[132] to be no longer confined to the context of poor and ignorant expectant heirs but applicable to poor and ignorant persons in general, such rationale as first established has survived, despite the courts' frequent description of those persons as "poor and ignorant".[133]

Obviously, the "poverty" element is irrelevant in this consideration of contracting parties' lack of understanding of the implications of contract terms. It is the "ignorance" element which is relevant here and what is to be demonstrated is that this equitable doctrine has appeared to have no effect in the light of incomprehensibility or unintelligibility found in a contract. The first hurdle lies in the limitation of the doctrine itself. As stated earlier, the limited application of the doctrine in England is already notorious when it restricts the circumstances of weaknesses, the taking advantage of which needs protecting against, to being poor or ignorant whereas in other jurisdictions the equivalent doctrine, which in fact originated from the English doctrine itself, extends to a wide range of conditions which place one party at a serious

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[130] See, for example, *Earl of Aylesford* v. *Morris* (1873) 8 Ch. App. 484.

[131] See, for example, *Earl of Ardglasse* v. *Muschamp* (1684) 1 Vern. 237, 23 E.R. 438 (execution of a rent charge of £300 *per annum* for a consideration of £300 so as to have money to live in London in riot and debauchery after forsaking the wife).

[132] (1888) Ch. D. 312.

[133] The decision in the Privy Council case of *Hart* v. *O'Connor* [1985] A.C. 1000 is also illuminant of this conclusion. In this case, an undervalue sale was made with a person of unsound mind, who was obviously unable to know the real value of the property. The Privy Council refused to set aside the contract both on the ground of lack of mental capacity and unconscionable bargain since the purchaser did not know of the vendor's mental condition at the time of the contract, hence no advantage taken of such ignorance. No poverty was involved in this case at all. If the doctrine of unconscionable bargain had required both poverty and ignorance, the Privy Council would have rejected the remedy simply by reason that the vendor was not poor.

disadvantage.[134] This issue falls outside this thesis's scope of investigation. The concern here is with the limitation in the "ignorance" element. It seems that ignorance in the modern context of inability to understand complex terms contained in written contracts does not amount to "ignorance" as required by the doctrine. In early cases, ignorance which attracted the equitable supervision was much in the form of foolishness. Even though the court in *Cresswell* v. *Potter*[135] has taken into account the *euphemisms of the 20th century* and developed the concept of ignorance to connote "*less highly educated*" (by which what the court had in mind was not the difference in the parties' educational qualifications but the knowledge *merely in the context of the transaction in question*),[136] this concept has still left unprotected the lack of understanding of the *meaning* of contractual terms since the courts' emphasis is only placed on the lack of knowledge *of the true value of the property*, not of other non-price terms.

Even if we grant that the inability to understand complex terms in a contract is the type of ignorance under the doctrine's perception, there remains another hurdle, the principal hurdle, which deprives contracting parties of relief under this equitable doctrine. This hurdle is the absence of the advantage-taking. The fact that firms employ in their contracts terms couched in incomprehensible language, often coupled with complex organisation, is a spurious proxy for their culpable intention to create the lack of understanding amongst consumers. It hardly represents the scenario in which industries had conducted an initial pre-assessment of their targeted consumers' ability to understand the linguistic complexity and then deliberately resorted to the complex draftsmanship for the particular purpose of preventing that class of consumers from understanding the terms drafted.[137] Rather, it is the product of legal technical

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[134] See footnote 8, *supra*.

[135] [1978] 1 W.L.R. 255.

[136] [1978] 1 W.L.R. 255, at 257 per Megarry J.

[137] This argument applies with equal force to the case of the prevention by transaction haste from knowing or ascertaining the terms of the contract. It is untenable to say that firms take advantage of the prevalent hasty circumstance. Such transaction haste is the self-created incident in the world of commerce.

sophistication. In addition, it may be related to the recognition of business elegance—a firm which expresses its contract terms in plain language might perhaps be regarded by the market as belonging to a lower business rank. Given all this, it is indiscernible to equate the use by a firm of complex drafting techniques with the advantage-taking of the other party's ignorance. Therefore, the doctrine of unconscionable bargain is, without more, inoperative in written or standard-form contracts as far as ignorance of the implications of contractual terms is concerned. Indeed, Eisenberg[138] appears to hold the similar view when he asserts that the law governing the enforceability of preprinted terms should not necessarily be grounded on "unfair exploitation" or fault and, rather, it should rest upon the foundation of "bounded cognition".

In this connection, Chen-Wishart[139], in her examination of the doctrines of unconscionable bargains both of England and of some other common law jurisdictions, has canvassed and presented an overall picture of uniformity of contracting parties' circumstances of special disability of which the other party takes advantage by either active or passive victimisation. One of her extracted categories of operative disability is the ignorance or misunderstanding of the contract or the lack of information, in respect of which she contemplates the situation where the contracting party fails to understand the jargons or concepts accompanying some complex transactions or the legal implications of a particular transaction.[140] This also incorporates the issue of informational asymmetry or ignorance now under consideration. Chen-Wishart appears to maintain that the ignorant party can (or should) be granted relief under this equitable doctrine since the party who uses such complex terms can be said to be creating a misapprehension and then actively taking advantage of the other party's ignorance (active victimisation).[141] This view is largely fallacious in the context of written (and, in particular, *consumer* standard-form) contracts, for a firm can be said to be taking advantage of the ignorance of the contracting parties only in the extremely rare case

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[138] *Op. cit.*, (footnote 105, *supra*), at 247.

[139] *Unconscionable Bargains*, *op. cit.*, (footnote 4, *supra*).

[140] *Ibid.*, pp. 38-39.

[141] *Ibid.*, pp. 74-75.

where its direct intention to create the parties' inability to understand the terms is particularly present, as in the case involving the "deliberate pre-assessment" previously mentioned—where a firm wilfully surveys the level of its targeted consumers' ability to understand the linguistic complexity and then couches its contractual terms with a higher level of unintelligibility than what consumers can perceive.

Although the advantage-taking of a party's inability to understand the implications of contract terms is inconceivable in the "firm-consumer" scenario, it would be much discernible in the personalised context in which a contract is made between two individuals neither of whom deals with each other in the course of business; and it is for this reason that it can be suggested that a general rule to give the courts the power to control contract terms should not extend to this very context. In effect, the inclusion of unintelligible terms in a contract of this setting is already extremely rare. Nevertheless, even when it exists, it is simply submitted that unfair results which have arisen from ignorance of the complexities in contracts reached in this personalised setting should be remedied with an aid of the equitable doctrine of unconscionable bargains. It is undeniable that in England this doctrine is still limited as regards the type of ignorance which can attract the operation of the doctrine. But this limitation can be solved by introducing a different rule expanding the application of this doctrine rather than by the same general rule. The advantage and expediency of this separation is the marked distinction between the case of the direct advantage-taking and that where such direct advantage-taking is absent. Such a distinction will help prevent confusion which is otherwise likely to be caused by the increasing level of abstraction in judicial reasoning, and will, in turn, assist the courts in clearly stating the real ground of the decision as to unfairness of the contract term concerned. This confusion has, in reality, been found in the United States in cases concerning U.C.C. § 2-302, which will be discussed in Chapter 4. The demerit of this foreign experience should be learned and rectified by the English legislature when designing the parallel general rule.[142]

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[142] Notably, the fact that the exclusion of a "consumer-consumer" contract from the operation of the proposed general rule is here discussed only in relation to the contractual ignorance which arises directly from the "*incomprehensibility* of the contract term concerned" may trigger the question

The same analysis as in the preceding paragraph should be applicable to contracts which are not in writing. As with a contract between two private consumers, the likelihood of complex terms being included in oral contracts is extremely rare. Even when a firm uses such terms in its contract made with an individual consumer by word of mouth, such a contract is more personal and the consumer's inability to comprehend the harshness of the terms offered would be obvious to the firm, so that if the contract is finally accepted without the implications of the terms being explained to the ignorant party the firm can be regarded as having taken advantage of such party's ignorance. At least, the firm should have reasonably realised that the acceptance by such party of those unfair terms was, failing other reasons which may bring the case into substantive unfairness *per se*, caused by his inability to understand the terms. When this kind of *passive* victimisation is present, the unfairness in the result of the contract should be more appropriately treated under the equitable doctrine of unconscionability.[143]

Failing the operative relief under this equitable doctrine, statute has come to rescue the aggrieved party. The Unfair Contract Terms Act 1977, which will be discussed in Chapter 3, has generally provided for remedies only in the context of exclusion clauses. Other enactments such as the Consumer Credit Act 1974 seek to police contract terms only in some selected instances. Thus, in view of this limitation, time appears ripe for having special legislation giving the courts general jurisdiction to control contractual terms candidly rather than by covert tools (sometimes called "back-

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whether the position is the same in regard to the other two types of ignorance relating to contractual implications—ignorance stemming from the *inconspicuousness* of the terms and ignorance caused by the *lack of an opportunity to ascertain* contract terms. On meticulous reflection, it can be seen that the absence of an opportunity to ascertain contractual terms does not exist in the consumer-consumer scenario. In addition, the incidence of small or hidden print is also more theoretical than real in this very context. Also, in the instance in which inconspicuousness is merely in the form of want of a special caution about an onerous or unusual nature of the term, the personalisation inherent in the "consumer-consumer" contract will suitably prompt the element of advantage-taking. It follows, therefore, that our contention that contracts between two persons dealing with each other as consumers should be excluded from judicial scrutiny of unfair consequences can be accepted as applicable to all cases.

143 Again, although the exclusion of oral contracts from the operation of the proposed general rule for the control of unfairness is here addressed only in the light of the inability to understand complex terms, this exclusion can be true of all situations involving contractual ignorance. This is because the problem of inconspicuousness is entirely impossible in a contract made by word of mouth. Moreover, as regards the lack of a practical opportunity to ascertain contractual terms, the nature of such a contract renders it non-existent.

door recovery techniques")[144] and across the board rather than on a piecemeal basis, when ignorance is at issue. This approach of control is not, as one can agree with Isaacs,[145] a retrogression to "status" against Maine's famous "from status to contract" theory. It is, on the contrary, weeding ignorant consumers out of uncontracted terms.

Indeed, this general supervisory regime has just emerged during the pursuit of this thesis. The "Regulations on Unfair Terms in Consumer Contracts" have been made by the Secretary of State and came into force on July 1995 in implementation of a directive of the European Communities. This Directive and the implementing Regulations will be the subject of discussion in Chapter 5 of this thesis. Suffice it to say here that the movement towards the direction of a general rule such as this should be regarded as meritorious. It will, however, be pointed out in that later Chapter that

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[144] These techniques include the interpretation or implication of terms to achieve a fair result, the manipulation of traditional rules of contract law such as the rule of 'offer and acceptance' or the rule of 'consideration' (also called 'categorisation' technique or 'instrumentalism') and the application of notions of 'repugnancy' to exclude undesirable terms or ends. These techniques might lead to distortions and confusion. For example, the court, in construing a contract term to avoid what is felt as unfair, may ascribe to that term the meaning or the result which is manifestly inconsistent with what was actually intended by the contract or what could be legitimately understood, as in *Andrews Brothers Ltd.* v. *Singer & Co. Ltd.* [1934] 1 K.B. 17 (discussed in Chapter 4 at footnote 37, *infra*) and *Hollier* v. *Rambler Motors (AMC) Ltd.* [1972] 1 All E.R 399 (see Chapter 2, *infra*). For an example of American cases, see *Ferguson* v. *Phoenix Assurance Co.* 370 P. 2d. 379 in which the Supreme Court of Kansas construed that the insurance policy's definition of "Safe Burglary" as the felonious taking of property from a safe after which **all doors** of such safe bear the visible marks of the felonious entry" was intended to cover the situation where **only the inner door** of the safe had been punched open whereas its outer door had been opened without leaving any marks. For the illustration of the distortion and confusion stemming from the categorisation technique or instrumentalism, see *Williams* v. *Roffey Bros. & Nicholls (Contractor) Ltd.* [1990] 1 All E.R. 512 (C.A.), discussed in Chapter 2, *infra*. It is in this sense that Llewellyn says "Covert tools are never reliable tools": see Llewellyn, "*Book Review*", 52 Harv. L.R. 700 at 703 (reviewing Prausnitz's *The Standardization of Commercial Contracts in English and Continental Law*, Sweet & Maxwell, 1937). For more discussions on this issue, see Kessler, *op. cit.*, (footnote 78, *supra*) at 635 and 637; Slawson, *op. cit.*, (footnote 78, *supra*) at 562; Reiter, *op. cit.*, (footnote 78, *supra*) at 360; Llewellyn, *op. cit.*, (footnote 78, *supra*) at 732; John A. Spanogle, "*Analyzing Unconscionability Problems*" (1969) 117 U. of PA. L.R. 931 at 934, David Tiplady, "*The Judicial Control of Contractual Unfairness*", (1983) 46 M.L.R. 601 at 605; Comment, "Administrative Regulation of Adhesion Contracts in Israel", (1966) 66 Col. L.R. 1340 at 1341; Collins, *op. cit.*, (footnote 29, *supra*), pp. 256-260; Swan, *op. cit.*, (footnote 87, *supra*) at 20. For some English courts' opposing attitude towards covert tools, see, for example, *Gillespie Bros.* v. *Roy Bowles* [1973] 1 Q.B. 700 per Lord Denning M.R. at 415 and *George Mitchell (Chesterhall) Ltd.* v. *Finney Lock Seeds Ltd.* [1983] 2 A.C. 803 per Lord Denning at 810 (recent legislation had "removed from judges the temptation to resort to the device of ascribing to the words appearing in exemption clauses a tortured meaning so as to avoid giving effect to an exclusion or limitation of liability when a judge thought that in the circumstances to do so would be unfair").

[145] Nathan Isaacs, "*The Standardizing of Contracts*", (1917) 27 Yale L.J. 34, at 47.

some shortcomings are found in the contents of the aforesaid Directive and Regulations in regard to which reform should be called for.

5.2.3 The Level of Ignorance Deserving Protection

One consideration seems to have been overlooked by most theorists in the area of unconscionability in contracts and needs close attention here. Once the justification for having a general rule to police unfair terms in written contracts rests, in the majority of cases, upon the parties' inability to understand the legal implications of terms, the question arises as to which level of ignorance has sufficient merit to receive protection by law. It should not be intended by the proposed general rule to allow a party of unusually low intelligence to escape from his contractual liabilities merely on the ground that the terms are too difficult for him to understand although they have already been expressed in simple language which presents no apprehension problem to people in general. Granting relief by reference to the subjective standard in this fashion is over-protective and will be unjust to the firms and their business. Industry incentives may also be adversely affected. Rectification of unfair terms on the ground of ignorance should, therefore, be tied to the objective test of ignorance: the inability to understand such terms as general people are unable to understand.[146]

IV. RELATED ARGUMENTS IN RELATION TO INFORMATIONAL ASYMMETRY

1. "Will" Theory of Contract or Voluntary Consent Revisited

1.1 General Argument

It is unarguable that a contract is a vehicle for giving effect to the will of the parties. The parties make an exchange because they "will" some achievement. All contractual obligations must be created by a communion of will, consensus or

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[146] A similar view is found in Huge Beale, "*Unfair Contracts in Britain and Europe*", [1989] Current Law Problems 197.

voluntariness of the parties.[147] When it has been shown that a general rule for controlling contract terms is justified on the contracting parties' ignorance, this theory has an inevitable relevance to such a policing approach. On the one hand, it is relied on by opponents of this general rule in claiming that the party who suffers the unjust result must be held to that result since the agreement has been made out of his will. On the other hand, it can be invoked in the opposite direction to justify the striking out of unfair terms on the ground that the terms were not a product of the aggrieved party's will—there was no *consensus ad idem*. Both arguments rest upon the same question: whether ignorant parties who seek relief from such terms are taken to have willed or voluntarily consented to them at the time of the contract.

In the context of substantive unfairness *per se*, the common law has apparently adopted the first way of interpretation as above—any unfairness in the substantive result *per se* of a contract is taken to be created by both parties' will. This is reflected in the doctrine that inadequacy of consideration in a contract is immaterial and is not a basis for invalidating the contract.[148] The courts have been inclined also to apply this

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[147] By the middle of the nineteenth century, will theory had been implanted in English law. Historically, the reception of this theory was from the civil law of continental Europe. It is simply a product of natural law and natural lawyers such as Grotius and Pufendorf had vigorously propagated these ideas before they influenced Pothier whose work, *The Treatise on the Law of Obligations*, had a profound effect on the French Civil Code. Pothier's legal concepts including the will theory concept spread to England and were employed by English treatise writers. The will theory was used by Powell in his *Essay upon the Law of Contracts and Agreements*, the English first systematic treatise which gathered general rules and principles of contract, and was then adopted through the case law: see Atiyah, *The Rise And Fall of Freedom of Contract*, *op. cit.*, (footnote 5, *supra*), p. 405. Kindersley V.C. said in *Haynes* v. *Heynes* (1869) 1 Dr. & S.M. 426, at 423, 62 E.R. 442, at 445 "when both parties will the same thing, and each communicates his will to the other, with a mutual agreement to carry it into effect, then an agreement or contract between the two is constituted".

[148] The same is true of French and Prussian positions. In France, a reflection of the adherence to the will theory is found in the Code Civil drafting committee's rejection to adopt as a general rule the doctrine of *lésion* (i.e. disparity in value of exchange) which was proposed to be included in the Code. Berlier and other members of the drafting committee argued that the Code should not require equality in the value of an exchange and one of the reasons was that "*one must accept the responsibility and the consequences of one's actions*". As a result of their arguments, *lésion* does not invalidate a contract as a general rule but can merely provide evidence of fraud or mistake or duress. The parallel attitude is found in the codification of Prussian Law. The Prussian Code (The *Allgemeines Landrecht* of 1794) did not adopt the old Roman *laesio enormis* and provided that a disparity in price would not invalidate a contract "in and of itself": See Gordley, "*Inequality in Exchange*", *op. cit.*, (footnote 20, *supra*), at 1592, 1599-1601, 1660.

As for the roman law doctrine of *laesio enormis*, it was introduced to apply to a contract of sale as an exception to the general rule which had been adopted by early roman law that inadequacy of

position to the context of the "modern procedural unfairness", to the effect that a contracting party who is ignorant of the legal implications of terms contained in a written contract, be it because of inconspicuousness, impossibility of ascertainment or incomprehensibility, is taken to have willed and voluntarily consented to them. Such approach is largely untenable and is the incorrect version of the application of the will theory. Consider, for instance, the aggrieved parties in such contracts as in *Williams* v. *Walker* and *Unico* v. *Owen*. It is inconceivable that they consented to or voluntarily accepted those drastically harsh terms in their contracts. They simply failed to be aware of or understand the implications of those terms and were subsequently unfairly surprised at the resulting hardship.

Since this thesis presents the supervisory regime under which the courts can invalidate a particular contract term only when there exists some unfair substance which has been agreed to without the claimant's knowledge or understanding of it, it might be argued that when the state of knowledge and the resultant lack of will is the basis for such a judicial review, a contract term can simply be struck down regardless of substantive unfairness. This argument seems naive and unattractive. Not all contracts concluded without one party being aware of the legal effects of their terms produce hardship on the side of the ignorant party. In the absence of unfairness in the result, the ignorant party suffers no loss. It is, thus, unwise to allow judicial deletion of a contract term on the ground of procedural taint alone. To do so would indeed result in vexatious litigation. Indeed, aside from this "floodgate of litigation" consideration, it

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price was immaterial. Under the doctrine of *laesio enormis*, the seller was allowed to rescind the sale on the ground that the price agreed was less than half its real value unless the purchaser supplemented what he had paid so as to make up a fair price. *Laesio enormis* appeared in two constitutions of Justinian's Code—Cod. 4.44.2 and 8. This doctrine, however, did not extend to movables and did not apply to the reversed situation where the purchaser paid more than twice the fair price. This crudeness, coupled with the fact that *laesio enormis* was not known to the framers of later *leges* in the Theodosian Code, suggests that the rule was attributed to Justinian and the rescript of Diocletian and its introduction was to protect small landowners who sold their land to neighbours who possessed a stronger bargaining position although no fraud or coercion was present: see R.W. Lee, *The Elements of Roman Law*, 4th edn., (Sweet & Maxwell, 1956), p. 311; Barry Nicholas, *An Introduction to Roman Law*, (Oxford Clarendon Press, 1962), p. 175; W.W. Buckland, *A Textbook of Roman Law From Augustin to Justinian*, 3rd end., (Cambridge University Press, 1963), p. 486; J.A.C Thomas, *Textbook of Roman Law*, (North-Holland, 1976), p. 283 and also Rudolph Sohm, *The Institute: A Textbook of the History And System of Roman Private Law*, 3rd edn., translated by James Ledlie, (Oxford Clarendon Press, 1907), p. 403.

can be said that the refusal to enforce a substantively fair contract just because it is procedurally unfair is patently unsound even when judged from the perspective of natural justice or common senses. It might be argued that the law of contract all the time allows invalidation of a procedurally tainted contract regardless of substantive unfairness, as is typical of "duress" (of person or goods) and "actual undue influence" cases.[149] But these are procedural improprieties which represent *mala in se*. When a procedural defect is not a *malum in se*, the legal doctrines give effect to a contract if its outcome is not unfair. As we have seen in Chapter 2, such is the position in "economic duress" and "presumed undue influence" cases. *A fortiori*, it is indiscernible that scenarios involving ignorance about the implications of contractual terms exhibit *mala in se*. Both procedural and substantive unfairness should be required in order to refuse enforcement of such a contract or its terms.[150]

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[149] See Chapter 2, *supra*, for some particular discussion of duress and undue influence.

[150] In "*In Defence of Substantive Fairness*" (1996) 112 L.Q.R. 138 which emerged near the completion of this thesis, Stephen A. Smith appears to present the same view when he says that substantive unfairness cannot be reduced to procedural unfairness since if we say that the problem with an unfair contract is entirely procedural, we stand committed to impugning the significant number of entirely fair agreements such as a fair loan in which the borrower does not fully understand the significance of compound interest or a salvage agreement in which the owner of a lone tugboat, who happens to be a "situational monopolist", demands a reasonable rescue fee: see *ibid*, at 143.

In this article, Smith defines substantive unfairness as the significant deviation from either a competitive market price or a normal price. However, he intends to use the term "price" to connote both monetary and non-monetary terms. (Put another way, substantive unfairness can be found in "price terms" and "non-price" terms alike.) Coincidentally, his approach of concern over substantive unfairness is largely in line with the approach advanced in this thesis. Smith concedes that a substantively unfair contract term (i.e. an abnormal price according to his definition above) should not be enforced when it appears that the worse-off party *cared about price* (that is, he did not intend to make a gift) *and* that the gaining party was in a better position to prevent the harm caused by the deviation in price. In this connection, Smith asserts that the two situations from which abnormal prices are most likely to arise are (1) when a party agrees to pay more than the normal price as a result of the misunderstanding of the terms of the contract or the normal price of the goods and (2) when the losing party contracts with a monopolist. To Smith, in both situations, the potential gainers, who are normally more experienced and draw up the contract, are better able than the losers to prevent the resulting harm; the losing party can be regarded as not being in such a better position than the gaining party when, for example, he is also skilled and experienced: see *ibid.*, at 153, 154. Apparently, the requirement that the losing party "care about the price" is in agreement with what this thesis calls "substantive unfairness *per se*": no invalidation if the losing party did not care about the unfair outcome of the contract, as in the case where he has agreed to it knowingly and voluntarily. More truely, Smith's emphasis on the common situation where a contract has been concluded without the losing party fully understanding its terms can be squared with this thesis' accentuation of the problem involving ignorance. As regards monopoly, it should be remembered that this thesis does *not* advocate that it is not a form of procedural unfairness which triggers substantively unfair contracts. The thesis merely suggests that monopoly is under control by legislation so that it is *unnecessary* for it

1.2 Implications of *Lynch's Case*

In England, the emergence of *Lynch* v. *D.P.P for Northern Ireland*,[151] which was decided by the House of Lords, has a significant impact on the will theory at common law and may be claimed to be at great variance with the argument addressed above. A number of scholars interpreted this decision as meaning that the House of Lords has unanimously discarded this theory. Actually, this case concerned the "overborne will theory of duress" but its decision can have a general impact on all cases involving the "will" of the contracting parties, including the cases concerning ignorance about the implications of contractual terms. It should be recalled that in duress cases, the party submitted to duress is said to have his will overborne by the party exerting duress. If *Lynch's case* is interpreted as the House of Lords saying that under duress the party's will is never overborne or vitiated, the consequence will be the following: even the threatened party is taken to have fully willed or voluntarily consented to the transaction, *a fortiori* want of voluntary consent of ignorant contracting parties in written contracts is indiscernible. However, this version of interpretation is not uncontroversial.[152] This section is devoted to demonstrating, firstly, that a different version of the House of Lords' decision is also persuasive and

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to be covered by a general rule empowering the courts to invalidate the contract on this ground. Nevertheless, it should be said that while Smith seems to believe that a "price" term can be struck down (for instance, when the losing party did not know of cheaper prices in the market), this thesis argues against this view. *Cf.* his most recent article "*Future Freedom and Freedom of Contract*", (1996) 59 M.L.R. 167 where he suggests that the central justification for the refusal to enforce "autonomous-endangering agreements" (such as self-enslavement contracts, restrictive covenants, stipulated damages clauses, specific or injunctive relief) lies in the concern for "future freedom" by which he means the promotion of valuable ways of living or valuable activities.

[151] [1975] A.C. 653.

[152] There has appeared a serious debate between Atiyah and Tiplady on the interpretation of the decision in this case. Atiyah views Lynch's case as a total demolition of the theory that duress operates by "overbearing the will" of the party subject to it and sounds an alarm that a number of cases postdating *Lynch's* case overlooked this House of Lords' decision: see Atiyah, "*Duress and the Overborne Will*", (1982) 98 L.Q.R 197. Tiplady argues, in response, that Atiyah's conclusions are largely unsound and misinterpret the decision in this case in which, he believes, the House of Lords never unanimously agreed in rejection of the overborne will theory of duress: see David Tiplady, "*Concept of Duress*", (1983) 99 L.Q.R 188, at 189, 193 in particular. Atiyah, in another article, in reply to Tiplady's attack, affirms the correctness of his interpretation and asserts that Tiplady himself seems to misrepresent the effect of the Lords' speeches: see Atiyah, "*Duress and the Overborne Will Again*", (1983) 99 L.Q.R 353.

consistent with this thesis holding that an ignorant contracting party has not given his real consent to unfair terms, and, secondly, that even if the former version of interpretation is really what was intended by the House, it has persistently been ignored in later decisions, so that the assertion that ignorance results in want of consent can still survive.

Lynch v. *D.P.P. for Northern Ireland* is, in fact, a decision on the criminal law. In this case, the appellant was charged with the murder of a police constable in Northern Ireland. He was a principal in the second degree in that he had driven three armed men, who belonged to a group of the I.R.A., to a place near where the policeman was stationed and was shot dead by this group. The appellant pleaded the defence of duress to this charge, contending that he had been ordered by a member of the I.R.A who appeared on the facts to be a "ruthless gunman who would tolerate no disobedience". The House of Lords held that the defence of duress was open to the accused. Notably, although the case concerned the criminal law, the Lords also discussed the nature and the meaning of the concept of duress and two of their Lordships (Lord Wilberforce and Lord Simon) in fact referred to the analogy of contract law, evincing that the principle laid down in *Lynch's case* will apply with equal force to contract cases. In this connection, what has resulted in the belief that the Lords have unanimously rejected the "overborne will" theory of duress lies principally in the speech that the victim (of duress) *completes the act and knows that he is doing so*; so that duress is not inconsistent with act and will. For the purpose of later exposition, some of the Lords' speeches are herebelow quoted:

> "Coactus Volui" sums up the combination: *the victim completes the act and knows that he is doing so*: but the addition of the element of duress prevents the law from treating what is done as a crime. One may note—and the comparison is satisfactory—that an analogous result is achieved in a civil law context: *duress does not destroy the will, for example, to enter into a contract, but prevents the law from accepting what has happened as a contract valid in law*."[153] (per Lord Wilberforce)

> "In my view, the law has recognized that there can be situations in which duress can be put forward as a defence. Someone who acts under duress may have a moment of time, even one of the utmost brevity, within with he decides whether he will or will not submit to a threat. There may consciously or

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[153] [1975] A.C. 653, at 680 (italics added).

subconsciously be a hurried process of balancing the consequences of disobedience against the gravity or the wickedness of the action that is required. *The result will be that what is done will be done most unwillingly but intentionally.*"[154] (per Lord Morris of Borthy-y-Gest)

"... the law also accepts generally as an axiom the concept of the freehuman will—that is, a potentiality in the conscious mind to direct conscious action. ..... "Volition" I take to be synonymous with "will" (i.e. the power of directing action by *conscious choice*); so that an "act" is a voluntary physical movement..... I hope, indeed, to have demonstrated that *duress is not inconsistent with act and will, the will being deflected not destroyed;* so that the intention conflicts with the wish. The actor under duress has performed an act which is capable of full legal effect."[155] (per Lord Simon of Glaisdale)

On reflection of these speeches, it is not easy to determine the Lords' intended meaning. On the one hand, it can be interpreted that the Lords did not decide in rejection of the "overborne will" theory of duress. In reiterating the fact that the victim of duress knew the act he was committing and saying that his will was not destroyed by duress, the Lords could merely be considering the presence of *mens rea* (i.e. intent) of the victim of duress in his commission of the act calculated to a crime.[156] Generally, *mens rea* in criminal law is the knowledge or awareness of the substance of the act. However, it is not necessarily equated with "will" or "willingness"—a man who, under threat of life, killed another person is regarded, in law, to have done so with *mens rea* since the act was *knowingly* committed but under such threat of life he was *never willing* to kill the victim. The recognition of the overbearing of the threatened party's "will" in the sense above was evident in Lord Morris's speech: "... what is done will be done most *unwillfully but intentionally*"—"unwillfully" indicates the overborne will and "intentionally" refers to *mens rea.* The same seemed to be intended by Lord Simon. In saying: "*...duress is not inconsistent with act and will, the will being deflected not destroyed*", his Lordship seemed to employ the term "will" to convey a different meaning from its ordinary meaning of "willingness" or "consent". "Will" in his speech was, in fact, defined as the "consciousness" or "conscious mind" (a potentiality

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[154] [1975] A.C. 653, at 670 (italics added).

[155] [1975] A.C. 653, at 695 (italics added).

[156] Notably, the crux of the decision in *Lynch's* case is, in reality, the determination as to whether a plea of duress was open to the accused as a principal in the second degree (aider and abetter) in a charge of murder.

in the conscious mind to direct conscious action)[157] on the part of the threatened party, which is the sense similar to "*mens rea*". This being so, in uttering the expression above, Lord Simon could merely mean that duress is not inconsistent with the intent or awareness of the act done under duress. The perusal of these speeches, therefore, reveals that the Lords never rejected the "overborne will" theory of duress.

On the other hand, Lord Wilberforce's speech can be interpreted differently. In addressing that "*the will of the threatened party is not destroyed since he completes the act and knows that he is doing so*", his Lordship apparently intended to discard the theory that the victim of duress lacks his will. It is noted that Lord Wilberforce, in using the term "will" did not have in mind any different meaning from its ordinary meaning, as Lord Simon did, and even extended his supposition to a civil case of duress[158](where "will" simply means willingness or voluntariness). If this interpretation is correct, it would be too radical.[159]

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[157] See the extracted passage at p. 71, *supra*.

[158] See the extracted passage at p. 70, *supra*.

[159] Proponents of this interpretation may mostly find support from the fact that the law treats a contract under duress as only voidable, not void *ab anitio*. Amongst this class is Atiyah: see his *Duress and the Overborne Will*, *op. cit.*, (footnote 152, *supra*). However, this submission may be overstated. Historically, divergence of opinions on this issue has been found in case law itself. For instance, the law of marriage once regarded a marriage under duress void for lack of consent. By parity of reason, there should be no difference in the legal effect between a contract made under duress and a marriage under duress: see D.J. Lanham, "*Duress and Void Contract*", (1966) 29 M.L.R. 615. Another reason advocated by Lanham for treating a contract made under duress void *ab anitio* rather than voidable appears plausible. He argues that regarding such a contract as merely voidable may result in an absurd clash between civil law and criminal law relating to larceny by intimidation and robbery, in that when the contract is to pass property, the party exercising the threat can be guilty of larceny by intimidation and yet be in a position to give a good title to a third party as if the property had legitimately passed to him at the outset, given that a voidable contract may not affect the right of a third party to whom the property is transferred by the guilty party.

For the purpose of comparison, see also Posner's extreme view that the reason for avoiding a contract under duress is not the lack of will. Here Posner puts it. A points a gun at B saying "Your money or your life". B is very eager to accept the first branch of this offer by tendering his money. But the court will not enforce this resulting contract. The reason is *not* that B was not acting of his own free will. On the contrary, he was no doubt extremely eager to accept A's offer. The reason is that the enforcement of such offers would lower the net social product, by channeling resources into the making of threats and into efforts to protect against them: see Posner, *Economic Analysis of Law*, *op. cit.*, (footnote 9, *supra*), p. 113. This is too radical a claim. It must be remarked, for example, that where the court refuses to enforce the contract when it appears that A points a gun at B to force B to sell B's property to A at a price much higher than the market price (and suppose that B is unable to use this property productively and efficiently), the reason for not enforcing the contract is, obviously, not the prevention of lower net social product but simply the lack of voluntariness.

Whichever interpretation is correct, the assertion that in acceding to unfair terms in written contracts the will or voluntary consent of ignorant parties *vis-à-vis* those terms is lacking can still survive the uncertainty arising from *Lynch's case*. Obviously, it survives if the version of the interpretation that *Lynch's case* did not reject the overborne will theory is correct. However, even though the extreme version of interpretation is let to stand, it can still survive. Firstly, this radical interpretation appears to have been ignored, if not explicitly rejected, by the courts deciding later duress cases. *Lynch's case* has not been alluded to by the courts and the courts have still affirmed the view that duress is a coercion of will.[160] Secondly, and importantly, since this radical interpretation is based on the premise that the party had his full will so long as he *completed the act and knew what he was doing*, it can be argued that the contracting party who was hindered (either by inconspicuousness or by transaction haste) from awareness of the contract terms concerned or who was unable to understand their implications knew only that they were making a contract with reasonable terms, but not that they were entering into unfair clauses contained therein; hence his will or voluntary consent *vis-à-vis* those egregious clauses was simply lacking.

1.3 Significance of Voluntariness Under "Balance Theory" of Contract

One contract theory which has emerged during the last few decades is the so-called "balance theory", as jointly proclaimed by Levin and McDowell.[161] This theory, although intended to be of general application, is peculiarly addressed in response to contracts of adhesion. Levin and McDowell, like other critics, appreciate the

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[160] See for example, *The Siboen and The Sibotre* [1976] 1 Lloyd's Rep. 293; *The Atlantic Baron* [1978] 3 All E.R. 1170; *Pao On* v. *Lau Yui Long* [1980] A.C. 614 (Privy Council). In particular, see *The Universe Sentinel* [1982] 2 All E.R. 67 (H.L.) in which the House of Lords considered whether a threat to black the plaintiffs' ship was economic duress and said, at 75: "It is conceded that the financial consequences to the shipowners of the Universe Sentinel continuing to be rendered off hire under her time charter to Texaco, while the blacking continued, were so catastrophic as to amount to *a coercion of the shipowners' will which vitiated their consent to this agreement*" (italics added). It should be observed that as a matter of criminal law, *Lynch's* case was overruled in *R.* v. *Howe* [1987] A.C. 417, [1987] 1 All E.R. 771.

[161] Joel Levin and Banks McDowell, "*The Balance Theory of Contracts: Seeing Justice in Voluntary Obligations*", (1983) 29 McGill L.J. 24.

practicality of the use of standardised packs to serve the mass-production era but are concerned with the "lack of real choice" which has often vitiated voluntariness of contracting parties. They concede that the paradigm contract, in which both parties carefully negotiate with equal bargaining power and are fully aware of the implications of all terms, exists but is increasingly rare. They claim, therefore, that the "balance theory" is needed. Two concepts—voluntariness and fairness—must be balanced against each other. They are to be weighed together with a given sum necessary to continue with the equation. As voluntariness increases, the need for an official examination of the fairness of the transaction lessens. As voluntariness wanes, there must be proportionately more fairness. With this theory, the all-or-nothing test can be avoided.[162] This theory is plausible and is in line with the control framework proposed by this thesis. Its appeal for abstention from interference with the unfair outcome when voluntariness is not vitiated squares, indeed, with this thesis's account of no rectification of substantive unfairness *per se*. And, in the context in which contracting parties are unaware of or unable to understand contract terms, their voluntariness tapers off and the courts should be justified in insisting that the terms be more just.[163] In effect, Levin and McDowell have demonstrated that this balance theory can be fit in many decided cases. They contend, for example, that when Wright J. grounded the invalidation of the "add-on" clauses on, *inter alia*, an absence of the meaningful choice, this analysis shares the criterion as embodied in the balance theory.[164]

2. Objective Theory of Contract

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[162] *Ibid.*, at 26, 30, 81.

[163] One observation should, however, be made in connection with Levin and Mc Dowell's advocation of voluntariness. There, they assert that voluntariness must be analysed *via* consent and they distinguish *consent* from *assent*, in respect of which they view that consent must carry clear understanding of the nature and scope of the obligation whereas assent is a weaker term which implies merely passive acquiescence to someone else's proposal: *ibid.*, at 43, 44. In this connection, although it can be accorded that consent entails full understanding of the implications of contract terms, it is felt here that such distinction is more conceptually confusing than useful, given the frequently interchangable use of both terms.

[164] *Ibid.*, at 74.

The related theory which must be considered in conjunction with voluntary consent of contracting parties is the objective theory of contract which also has a place in common law. Although *consensus ad idem* is a part of the law of contract, the common law has long formulated the "objective test" of consent which holds that this *consensus ad idem* to any terms in a contract is not to be ascertained from the actual meeting of the minds or inward intention of the parties, but from the outward appearance or conduct which each party leads the other reasonably to believe that he was agreeing to be bound by such terms although he did not actually so intend. The principle was first established by Blackburn J. in *Smith* v. *Hughes*[165] although in stating it he relied on the rule previously laid down in *Freeman* v. *Cooke*[166] which, though concerning estoppel, was felt to be generally applicable to cases involving contractual consent. The principle is encapsulated in his passage which usually features in contract law textbooks in the chapter headed "mistake":[167]

> "The rule of law is that stated in *Freeman* v. *Cooke*. If whatever a man's real intention may be, he so conducts himself that a reasonable man would believe that he is assenting to the terms proposed by the other party, and that other party *upon that belief* enters into the contract with him, the man thus conducting himself would be equally bound as if he had intended to agree to the other party's terms".[168]

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[165] (1871) L.R. 6 Q.B. 597 (a sale of oats when the buyer understood the oats to be warranted to be old oats).

[166] (1848) 2 Ex. 654.

[167] (1871) L.R. 6 Q.B. 597, at 607 (italics added).

[168] There has been found in some cases a more stringent objective test which proclaims that a party's consent is judged not according to what *the other party* (as a reasonable man) reasonably understood it to be but according to what a reasonable *bystander* who observed the negotiations would have understood it to be. This approach was generally attributed to Lord Denning's judgment in *Solle* v. *Butcher* [1950] 1 K.B. 671, 691; *Leaf* v. *International Galleries* [1950] 2 K.B. 86, 89; *Frederick E. Rose (London) Ltd.* v. *William H. Pim Junior & Co. Ltd.* [1953] 2 Q.B. 450, 460. However, as a matter of case law, the "*Smith* v. *Hughes*" test has prevailed over the "bystander" test. The bystander test (sometimes called the "detached objectivity": see William Howarth, "*The Meaning of Objectivity in Contract*", (1986) 100 L.Q.R. 265 at 275) can lead to a particularly absurd result in that if *both parties* inwardly intended and agreed on the same term or the same thing but a bystander understood their negotiations to refer to a different term or something else, the contract would have been taken to be made on that stranger term or thing at variance with the real intention of both parties to the deal. For fuller criticisms, see J.R. Spencer, "*Signature, Consent, and the Rule in L'Estrange* v. *Graucob*", [1973] C.L.J. 105 at 112.

This theory is thus central to the issue of the ignorance about the existence or the implications of contract terms. Apparently, it might be invoked by protagonists to treat the ignorant party as *ad idem* to the terms to which he seeks to deny his agreement. Conventionally, the rationale of this objective theory is based on the reliance ground, although economist lawyers have also attempted to find an economic foundation for it. The following sections will point out that when the theory is called into play in the light of ignorance about the terms of written (particularly standardised) contracts, it is unimaginable, from either point of view, to conclude that the ignorant party is taken to have been *ad idem* to the term in which ignorance lies.

2.1 Reliance Ground

The conventional judicial rationale of objectively interpreting a contracting party's consent rests upon the combined facts that his outward intention, whatever the inward state of mind may be, (mis)led the other party reasonably to believe that he (the first party) was really assenting to the terms of the contract and that other party actually *relied on* such belief in entering into the contract. This is evident from Blackburn J.'s statement above itself. It can also be noticed from the fact that the reason given by the court in *Freeman* v. *Cooke*, the case upon which Blackburn J. relied, for estopping the person who made a representation of fact to another from proving that that fact was in reality untrue was that the representee relied upon that representation to his detriment.[169] Obviously, if it appears that the party to whom the

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[169] As the estoppel case of *Freeman* v. *Cooke* which is indeed the origin of the objective test required not merely reasonable reliance but some kind of *detrimental* reliance, the courts in later cases have tended to require this type of reliance (and have even occasionally explained the test in the language of estoppel) as well: see, for example, the House of Lords' decision in *Paul Wilson & Co. A/S* v. *Partenreederei Hannah Blumenthal* (*The Hannah Blumenthal*) [1983] 1 A.C. 854 at 915-916 (the conduct leading to the belief that a contract to abandon an arbitration was formed) where Lord Brandon required the *significant alteration of position in reliance on that belief.* (Lord Diplock agreed and described it as "injurious reliance".) See also *Tracomin SA* v. *Anton C. Nielsen A/S* [1984] 2 Lloyd's Rep. 195 which similarly concerned the arbitration abandonment contract where the court found the "injurious reliance" in that the plaintiff had disposed of all relevant files and documents in reliance of the defendant's conduct; *André & Cie SA* v. *Maritie Transocean Ltd.* (*The Spendid Sun*) [1981] Q.B. 694 per Eveleigh L.J. at 706. However, it is submitted that "detriment" should not be necessary in cases which do not concern estoppel by representation since the objective theory is simply a rule of interpretation of communication: see John Cartwright, *Unequal Bargaining*, (Clarendon Press Oxford, 1991), p. 15. See also Anne de Moor, "*Intention in the Law of Contract: Elusive or Illusory?*", (1990) L.Q.R. 632, at 641-642 (arguing that attempts to categorise the objective theory as a form of "estoppel" have obscured the genuine theoretical basis for the theory).These views have

other party's apparent consent was communicated did not actually believe that the conduct of the latter was a genuine assent to the terms of the contract, the merit of this objective ascertainment of intention will cease to stand and the mistaken party is thus justified in denying his consent. As a matter of fact, this has occurred in decided cases in which the mistake on the part of the mistaken party was known or ought to be known to the party seeking to enforce the contract[170] or where the party who seeks such enforcement caused or contributed to cause the mistake.[171]

This doctrinal foundation of objectivity appears to have been accommodated by legal scholars as well as theorists. For instance, in the expostulation of his "consent theory" of contract, Barnett maintains that the manifestation of consent or intention to transfer an alienable right must be objectively ascertained precisely because objectivity respects and protects the rights and liberty interests of others whose plans and *expectations* would be severely limited if they were not entitled to rely on things as they appear to be.[172] Indeed, diverse expressions employed by legal scholars in defence

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increasingly gained support from later cases in which the detrimental requirement has not been stated (or has probably been indirectly discarded by holding that the other party's decision to enter into the contract in question, and thereby being induced not to enter into other contracts, sufficiently constitutes detriment): see, for example, *The Multitank Holsatia* [1988] 2 Lloyd's Rep 486 per Phillips J. at 493; *Allied Marine Transport Ltd.* v. *Vale Do Rio Doce Navegacao S.A.* [1985] 1 W.L.R. 925 (C.A.) at 936.

[170] See *London Holeproof Hosiery Company Ltd.* v. *Padmore* (1928) 44 T.L.R. 499 (C.A.) (an exercise by the plaintiffs of the option to purchase the rented factory, which had been burnt down, in the false belief that the defendant had undertaken to reinstate the building); *Hartog* v. *Colin and Shields* [1939] 3 All E.R. 566 (the mistaken quotation, in an offer letter, of the price of Argentine Hareskins by reference to the price "per pound" despite the negotiations contemplated the price "per piece").

[171] See *Scriven Bros & Co.* v. *Hindley & Co.* [1913] 3 K.B. 564 (a bid, in an auction sale, for bales of tow when the bidder believed them to be bales of helm and the auctioneer contributed to the mistake by using the same shipping marks on both lots).

[172] Randy E. Barnett, "*Consent Theory of Contract*", (1986) 86 Col. L.R. 269, at 303, 306. This "Consent Theory" ascribes contractual responsibility to a party only upon his consent to the transfer in question. The theory, in fact, begins with the "entitlement theory": in order to make a contract to transfer a right, a person must have legitimately acquired the right and that right must be of an alienable character: *ibid.*, at 291-293. Once a right is legitimately acquired and alienable, an individual may operate freely to pursue his personal ends by contracting to transfer it; and once an agreement is made to transfer a right, the right holder is then bound by the commitment only when he *consents* to the transfer: *ibid.*, at 298, 301.

of the value of the objective theory can be seen as being dovetailed into the "reliance" pillar.[173]

When the reliance model above is analytically applied in the light of contracting parties' (in particular, consumers') ignorance prevalent in modern markets, it can hardly yield the result that the party's real consent is overridden by his outward consent. This is true of all the three scenarios in which ignorance about unfair contractual terms is at issue. Consider, first, the ignorance occasioned by the inconspicuousness of the terms in a contract. Obviously, the presence of a term which is likely to escape the notice of the other party will intercept the reasonable belief on the part of the *proferens* that the ignorant party has genuinely assented to it; this interception is particularly veracious in the instance of small or hidden print. The same conclusion can be made of the second category of ignorance—ignorance generated by the absence of a practical opportunity to ascertain contract terms. This type of ignorance, though possibly found in a mere written but not standardised contract, in most cases occurs in transactions involving standard-form contracts.[174] Although the use of standard-form contracts and the application of linguistic abstruseness by the industry is not to be discerned as an advantage-taking of consumers' ignorance, firms nowadays are generally well aware of the regular necessity of speedy completion of transactions. Consequently, the reasonable belief which firms can claim to have upon consumers making contracts with them can scarcely be more than one that those haste-stricken consumers are agreeing only to such normal terms as are reasonably expected from the nature of the transaction concerned. Even in the case where all terms are

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[173] See, for example, G.H. Treitel, *The Law of Contract*, 9th edn., (Sweet & Maxwell, 1995), p. 1 ("commercial convenience"); Anne de Moor, *op. cit.*, (footnote 169, *supra*), at 634, 638 ("natural principle of interpretation"); Howarth, *op. cit.*, (footnote 168, *supra*), at 280 ("community value"). For the relationship between the common law objective theory and the notion of *culpa in contrahendo* (which was initially advanced by Jhering in Germany and then penetrated both civil and common law), see Kessler and Fine, "*Culpa in Contrahendo, Bargaining in Good Faith, and Freedom of Contract: A Comparative Study*", (1964) 77 Harv. L.R. 401, at 426-437.

[174] This is simply because where a contract is merely written but without any element of standardisation, the transaction concerned is hardly hurried. However, where it involves the speedy nature, the following arguments in relation to standard-form contracts equally apply to such transaction.

ostensibly put in red ink or bold face, this transaction haste should, as a matter of fact, restrict the firms to this level of belief and resultant reliance.

It is noteworthy that the common law rule concerning the incorporation of terms (which requires reasonable steps being taken to bring the term to the attention of the other party) has also been developed by reference to the objective theory of contract, in the sense that as long as one party has sufficiently given the other party the chance of noticing the term, the former will reasonably believe that the latter's apparent act of accepting the contract denotes his actual consent.[175] Based on this principle, the judicial impression may probably be that a person can be excused from a contract term *only in an exceptional case* where particular facts indicate that the party who seeks to enforce it knew at the time of the contract that the other party did not actually have the notice of it. This once occurred in Canada in *Tilden Rent-a-Car Co.* v. *Clendenning*[176] where the Ontario Court of Appeal held that the hirer who hired a car from a car-rental company was not bound by a very onerous term in the additional insurance contract—the term which had the effect that the insurance did not cover the hirer's liability for damage to the car when he consumed *any* quantity of liquor—because there appeared the particular fact that the company (through its clerk) knew that the hirer was in a hurry and did not read the document. To this, Cartwright sounds a caution that it is not as a matter of general rule that the law which is based on the objective theory allows the party to escape from the consequence of a term in his contract merely on the ground that he failed to read the term; it is just a matter of fact in a particular case.[177] Indeed, this caution can be obverted. In our present business

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[175] This can be seen from the reasoning stated by Blackburn J. again in *Harris* v. *Great Western Rly Co.* (1876) Q.D.B. 515 at 530 (concerning an exclusion clause contained on the back of a ticket) where it was explained: "...the preclusion (from denying the knowledge of the term) only exists when the case is brought within the rule so carefully and accurately laid down by Parke B in delivering the judgment ... in *Freeman* v. *Cooke*....". Also, in the context of signed documents, it was clearly explained by Dubin JA in a Canadian case of *Tilden Rent-a-Car Co.* v. *Clendenning* (1978) 83 D.L.R. (3d) 400: "the justification for the rule in *L'Estrange* v. *Graucob Ltd.* appears to have been founded upon the objective theory of contracts, by which means parties are bound to a contract in writing by measuring their conduct by outward appearance rather than what the parties inwardly meant to decide. This, in turn, stems from the classic statement of Blackburn J. in *Smith* v. *Hughes*."

[176] (1978) 83 D.L.R. (3d) 400.

[177] *Unequal Bargaining, op. cit.*, (footnote 169, *supra*), p. 50.

world, the speedy completion of contract is prevalent *not as an exceptional case* but as a matter of *regularity*. Firms know, or should reasonably know, that their prospective consumers do not have a practical chance to ascertain and be aware of unfair terms contained in their standard pads. Thus, it makes more sense to apply the objectivity in the direction that those haste-stricken consumers are not taken to have voluntarily agreed to abide by the unfair consequences of contractual terms. Cartwright also argues that mere transaction haste faced by one party, even if known to the other party, cannot preclude the normal operation of the objective theory in holding the former to have consented to the contract since it must be distinguished between the case where the haste-stricken party who failed to read the terms was taking the risk of what the terms would be (thereby reasonably imposing reliance on the other party) and the case where such risk taking was absent.[178] However, this argument loses its credibility when consumers in most cases are very unlikely to make a contract with such a risk-taking attitude.

Now, in the final context where the parties' ignorance merely emanates from inability to digest linguistic abstruseness, the same direction should be pursed.[179] This branch of ignorance can be as much present in standardised contracts as in written but not standardised agreements. In this context, the absence of reasonable belief (and the then reliance on such belief) on the part of the firm is even more easily visualised. Firms can be led reasonably to believe only that intending customers are consenting to such terms as are normally expected to be in the contract. It is in the face of reality to conclude, for example, that consumers in cases like *Williams* v. *Walker* or *Unico* v. *Owen* led the firms reasonably to believe that they genuinely intended to accept those harsh clauses in the contracts.

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[178] *Ibid.*

[179] Collins, *op. cit.*, (footnote 29, *supra*), pp. 118-119, concedes that the use of the objective theory must be restricted to the determination of the "existence" of a contract and cannot be extended to the interpretation of the "content" of an agreement or the meaning of its terms. This view is dubious and indeed runs counter to the judicial account such as in *Thake* v. *Maurice* [1986] 1 All E.R. 496 (the description by the surgeon of the effect of the vasectomy operation as "irreversible" was held, on its objective interpretation, not to be regarded as an undertaking or a warranty that the vasectomy would render the patient permanently sterile, having regard to the fact that medicine was not an exact science and that the results of operations were to some extent unpredictable).

However, such reasonable belief and reliance may actually materialise where the recipient of the standard-form or written contract appears to be a person engaging in trade or business. In this scenario, it is the business ability and alertness that prompts this belief. When the contract is made with a businessperson, the *proferens* is justified in presuming, at least, that the vigilant nature of the recipient must have brought this party to seek legal advice on the implications of the terms before deciding to finalise the contract. In addition, the likelihood of risk-seeking or risk-neutral attitudes on the part of traders is likely to activate the *proferens*'s reasonable belief that the recipient is giving real consent to the terms offered. It is against these business backgrounds that a general rule which should be introduced to allow claims of unfairness should not be applicable to parties who make the contract in the course of trade or business (and it is precisely on this footing that this thesis's discussions of ignorance as justification for controlling contract terms appear to surround consumers). It is noted that although the structural convenience in the thesis writing results in this issue being now laboured in the light of the ignorance which stems from the incomprehensibility of contractual terms, this "businessman exclusion" analysis can, by the same token, be true of the case of inconspicuousness as well. Further, given that the ignorance in the form of the lack of opportunity to ascertain contract terms (that is, the haste-related ignorance) does not typically occur in the "businessman-businessman" scenario, the view that businessmen should not be entitled to challenge unfairness on the ground of ignorance about contract terms can be proposed as a general position. Notwithstanding, a qualification should be attached to this general exclusion of merchant-to-merchant transactions from the protective coverage of the proposed general rule. It must not be overlooked that where a merchant engages in what can be viewed as a "one-man" business or acts as a single trader, such a merchant's position is, obviously, not much different from an ordinary non-trader's. In consequence, the belief and reliance *vis-à-vis* the conduct of this type of merchant should not be different from that in respect of general consumers. Thus, there will be no reason to exclude this class of merchant from the application of the general rule.

2.2 Economic Ground: Efficiency Promotion

As the "will" theory or the requirement of the meeting of the minds is simply the product of natural law, objectively holding the contracting party to be responsible at variance with his real consent (as occurred, for example, in mistake cases like *Smith* v. *Hughes* above) may shock the natural conscience of laypersons; and, notably, no such position is found in mistake cases under French or German law. Economist lawyers have asserted that this theory has a core of economic justification. According to this assertion, the mistaken party may have been in a better position to prevent misunderstanding or could have avoided the misunderstanding at lower cost than the other party, or was careless and, for the corrective or suppressive purpose, should be held to the contract. Posner, for example, states that ascribing liability to that party will make future mishaps less likely; that is, the law treats the misunderstanding as forming a contract in order to deter future failures.[180] Both arguments—"cheaper ignorance-avoider" argument and "future-mishap deterrence" argument—indeed point to the promotion of economic efficiency (in the sense of minimising costs and maximising wealth). If this objective theory is applied to written or standard-form contracts to the effect that to hold ignorant parties to unjust terms will more efficiently minimise the cost of avoiding ignorance or deter carelessness in being ignorant, it will obviously be fraught with difficulty in the following sense.

Firstly, to maintain that the ignorant party can more cheaply avoid the ignorance concerned is inconceivable in all contexts. It is obviously unimaginable in the context of unintelligible terms. Understanding those terms will incur costs of legal consultation which can be better saved (and thereby better promoting economic efficiency) by requiring the industries to express their terms in comprehensible language. The same is true of inconspicuous terms. Although the sight of small print or otherwise unnoticeable terms is viable without special help of a lawyer, it is more economically efficient to have the terms placed in an eye-catching manner. With regard to the ignorance prompted by transaction haste, the "cheaper ignorance-avoider" argument is irrelevant, for the speedy nature of transactions in modern markets is

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[180] *Economic Analysis of Law*, *op. cit.*, (footnote 9, *supra*), p. 100.

created as a result of the business growth itself and cannot be discerned as susceptible of being cheaply avoided by either party.

Moving on to look at the issue from the "future-mishap deterrence" point of view, it is erroneous to ascribe contractual liability to the ignorant party with a view to suppressing his careless conduct. Apparently, the fallacy is robust in the context of incomprehensibility. In most cases, inability to understand prolix and abstruse terms does not square with carelessness. Carelessness in this very context can only be found in the extremely more theoretical than real situation where, for instance, the consumer has access to free and prompt legal advice on the implications of the terms in question but chooses to make the contract without such advice when faced with no haste. Again, in the instance of haste-related ignorance, the carelessness argument is irrelevant. It might be argued that a party can be regarded as careless in the "inconspicuousness" instance. But even if failure to have notice of small print or simply unostentatious terms can be viewed as want of care, the suppressive measure can equally be taken against the *proferens*. Given all this, there is thus no sense to conjure the "economic core" of the objective theory in the direction of holding ignorant parties to unfair terms which their ignorance surrounds.

3. Fried's Contract as Promise Theory

Fried's "*contract as promise*" theory as explicated in his famous work named after this theory[181] is not to elude this thesis's examination since it also seems to run counter to the notion of allowing contracting parties to escape from liabilities existing under contract terms about which they are ignorant. As the title of his theory suggests, Fried justifies the enforcement of a promise on the *promise* itself. Once a promise has been made, the promisor is bound by it and the obligation is self-imposed. This theory, Fried expounds, hinges on the principle of morality. Here, he asserts:[182]

> "By promising we put in another man's hands a new power to accomplish his will, though only a moral power: What he sought to do alone he may now *expect* to do with our promised help, and to give him his new facility was our very

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[181] Charles Fried, *Contract As Promise*, (Harvard University Press, 1981).

[182] *Ibid.*, p. 8 (italics added).

> purpose in promising. By promising we transform a choice that was morally neutral into one that is *morally compelled*. Morality, which must be permanent and beyond our particular will if the grounds for our will are to be secure, is itself invoked, molded to allow us better to work that particular will."[183]

What is central to the discussion on the control of contractual terms is that Fried seeks to apply this "contract as promise" theory to various areas of contract law including the area of unconscionability or hard bargains. As far as a hard bargain is concerned, it is obvious that his theory suggests holding the victim of such a bargain to be bound by it since he has committed to the bargain and created trust in the other party. One example which Fried gives in order to demonstrate the undesirability of intervening in hard bargains contains the facts which are similar to those in *Williams* v. *Walker* and it is evident that this illustration is derived from this very case. Fried argues that the court should not intervene in these exorbitant credit terms. The reason of his first resort is that the terms are not unfair. The retailer who offers such terms is in fact offering customers further options and thereby enlarging their opportunities; that is to say, those destitute customers will have a chance to buy appliances on credit. Condemning these clauses as unconscionable will cause retailers to close up shops which would be to the disadvantage of those customers who are willing to accept such a hard bargain in order to obtain the goods.[184] This contention is misleading. Like Epstein,[185] Fried generally rejects the undoing of unconscionable terms but his rejection is generalised from only one class of consumers—the class of destitute buyers who fully appreciate the implications of those harsh terms and yet voluntarily accept them so as to obtain the goods which otherwise will not be offered. As earlier discussed, this rejection is fallacious when applicable to the other class of buyers—those who do not understand the implications of the terms and are unfairly surprised.

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[183] *Cf.* Barnett's "*consent theory*" of contract, (discussed at p. 77 and footnote 172, *supra*). It is noted that although Barnett iterates that his theory is distinct from Fried's "*contract as promise*" theory in that Fried justifies the enforcement of a contract on a commitment or a promise *per se* while the "consent theory" holds the promisor to be bound because of his manifested consent, this alleged variance seems rather artificial. On perusal, this "consent theory" does not much differ in essence from Fried's theory, since both theories justify contractual obligation on the resulting "*expectation*" of the promisor.

[184] *Op. cit.*, (footnote 181, *supra*), p. 105.

[185] See p. 45, *supra*.

In fact, Fried does not overlook this situation but seems to believe that those ignorant customers can have some relief under the doctrine of mistake and legislation which requires detailed and understandable explanations and period of time for reflection.[186] It can be argued that this will not do. Obviously, the English common law of mistake will not excuse the party from the obligation on the ground of lack of understanding of the term concerned, and this is also the case in many other jurisdictions. Moreover, legislation of such characters as said above has now been enacted merely on a selective basis; and, in this connection, it will be demonstrated shortly that even the requirement of disclosure or plain language, if introduced into the law at all, should not be a preclusion of the introduction of the judicial scrutiny in the substance of contract terms.[187]

Fried next argues that redistribution should be undertaken by way of general taxation. The retailer in the example above, Fried asserts, would pay taxes which would (or should) in turn go to reduce the poverty of the destitute clients. To Fried, there is no reason why the retailer should assume more burden in this regard than a Beverly Hills plastic surgeon with ten times the retailer's income just because the surgeon never has occasion to deal with the poor.[188] This argument appears more emotional than tenable. One can see that in the case of the destitute class of customers who understand the implications of the contract terms in question but prefer to be bound by them so as to achieve their personal (and subjective) goal, this argument is incontestable. The retailer should not assume more burden of remedying the poverty of his customers than through the taxes he pays since that poverty is not directly occasioned by the contract with him (and, indeed, the contract assists these customers in living better lives with the goods bought from him). However, in regard to the class of customers who had not accepted the terms but for their ignorance, the hardship suffered directly emanates from the terms in the contract and can hardly be remedied by taxation. (Further discussion on redistribution by taxation will be made shortly when

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[186] *Op. cit.*, (footnote 181, *supra*), p. 105.

[187] See p. 95 *et seq*, *infra*.

[188] *Op. cit.*, (footnote 181, *supra*), p. 106.

the concept of wealth maximisation is examined).[189] In effect, Fried is also aware that the liberal principle which insists upon redistribution only by taxation *assumes a well-functioning market*. On this assumption, Fried clearly states that hard clauses such as the no-warranty clauses offered by the cartel manufacturers cannot be allowed to stand.[190] If the "market perfection" assumption is pursued, it is puzzling why his "redistribution-by-taxation" argument should not be cast out in the context of contractual ignorance as well, given that ignorance is a type of market imperfections.

4. Posner's Wealth Maximisation: Unfairness Not Challengeable in All Contexts?

4.1 Overview

Posner is prominent amongst economist-lawyers who implore both the application of economic reasoning to explain law and the creation of legal rules which can promote economic efficiency.[191] His proposed criterion of economic efficiency is often called "*wealth maximisation efficiency*" which he contends to be the most appropriate criterion. Legal rules, to Posner, should be established, and similarly individuals should act, in such a manner as to increase and maximise social wealth. Posner's definition of wealth is different from mere happiness, satisfaction or utility but it is "the value in dollars or dollar equivalents of everything in society, measured by what people are willing to pay for something or, if they already own it, what they demand in money to give it up". The only kind of preference which counts in a system of wealth maximisation is thus one that is backed up by money, in other words, that is registered in market.[192] To maximise social wealth, Posner acknowledges that he

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[189] See p. 93, *infra*.

[190] *Op. cit.*, p. 107. Throughout his discussion in this regard, Fried does not state its relation to his "contract as promise" theory. But, when this theory is applied, it could be that the consumers in this setting do not actually commit themselves to the terms concerned, or that the cartel manufactures cannot "expect" the promised performance by those consumers.

[191] For economic efficiency, see pp. 10-12 and 24, *supra*.

[192] Posner, "*Utilitarianism, Economics and Legal Theories*", (1979) 8 J. of Legal Stud. 103, at 119.

adopts the Kaldor-Hicks criterion.[193] On many occasions, wealth increases without anybody being made worse off; but, more often, there will be both gainers and losers. If the gains can fully compensate the losses (irrespective of whether or not such losses are actually compensated), social wealth is increased and maximised and this criterion must be pursued. Posner believes that since this criterion results in wealth being maximised, it is in everyone's interest and thus everyone consents to it. This argument is often referred to as the "consent argument".[194]

Posner implores the pursuit of this criterion of efficiency in all branches of law, not only in contract law, and in *The Ethical and Political Basis of Efficiency Norm in Common Law Adjudication*,[195] his exposition of this criterion is made in relation to the law of negligence as to demonstrate how to choose a regime of liability rules—negligence rules or rules of strict liability—to reduce social costs and then maximise social wealth. However, this thesis's concern is only with the application of this wealth maximisation to the control of unfair terms in contracts which contracting parties enter into out of ignorance.

4.2 Two Versions of Application of Posnerian Wealth Maximisation to Contracts

4.2.1 Support of Perfect Market and Perfect Information

On the one hand, Posner's wealth maximisation can be a good support of the view that a contract should be concluded in a perfect market (with all parties having full knowledge), for it will result in the increase and maximisation of wealth of all parties, which will in turn contribute to the wealth of society as a whole. And if this contract causes harm to third parties, should the harm done not exceed the total gain

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[193] Posner, "*The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*", (1980) 8 Hofstra L.R. 487, at 491. For Kaldor-Hicks criterion, see p. 12, *supra*.

[194] See, for example, Coleman, "*Efficiency, Utility and Wealth Maximization*", *op. cit.*, (footnote 17, *supra*), at 531; Ronald Dworkin, "*Why Efficiency?*", (1980) 8 Hofstra L.R. 563, at 574 (reproduced in a modified form in Dworkin, *A Matter of Principle*, (Clarendon Press Oxford, 1985), Chap. 13, p. 267, at 275).

[195] *Op. cit.*, (footnote 193, *supra*), at 492-496.

of the contract, society's wealth is still maximised and this is Kaldor-Hicks efficient. In *Economic Analysis of Law*, Posner reiterates again that he suggests the Kaldor-Hicks concept. Here he says:[196]

> "If A values the wood carving at $5 and B at $12, so that at a sale price of $10 (indeed any price between $5 and $12), the transaction creates a total benefit of $7 (at the price of $10, for example, A considers himself $5 better off and B considers himself $2 better off), then it is an efficient transaction, provided that the harm (if any) done to the third parties (minus any benefit to them) does not exceed $7. The transaction would not be Pareto superior unless A and B actually compensates the third parties for any harm suffered by them."

This is clearly indicative of the application of Kaldor-Hicks-based wealth maximisation to contracts concluded in a perfect market. In the same work, Posner lays emphasis on economic theories and the mechanism of the perfect market (which includes perfect information). He enumerates three fundamental principles of economics; viz, (1) there is the inverse relation between price charged and quantity demanded, (2) consumers are trying to maximise their utility and producers to maximise profits and (3) resources tend to gravitate towards their most valuable uses if *voluntary exchange—a market*—is permitted.[197] Notably, in uttering "voluntary exchange", Posner also intends perfect information, apart from the very obvious requirement that the application of all opportunistic means to obtain the contract must be absent.[198] The interpretation that Posner contemplates perfect information is buttressed by his justifying the doctrine of immateriality of adequacy of consideration with reference to the economic reason that since a man is a utility or profit maximiser

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[196] *Op. cit.*, (footnote 9, *supra*), pp. 13-14.

[197] *Ibid.*, pp. 4-12 (italics added).

[198] Posner's intention regarding the absence of opportunistic behaviour is evident from his elaboration in the Chapter on Contract Rights and Remedies where he expounds that the fundamental function of contract law, recognised as such at least since Thomas Hobbes's days, is to deter people from behaving opportunistically towards their contracting parties in order to encourage the optimal timing of economic activity and obviate costly self-protective measure. In this connection, Posner invokes *Wood* v. *Duff-Gordon* (1917) 118 N.E. 214 as an illustration. This case concerned an exclusive dealership contract between a manufacturer and a dealer which did not specify that the dealer was under the obligation to use his best efforts to sell the manufacturer's product. The dealer was opportunistically better off by his inactivity. The court rectified this unfair result by implying the condition that the dealer had such obligation. Posner points out that where such opportunistic conduct is found, the court may sometimes attempt to strike it out by way of holding that the promise is not supported by consideration, as once occurred in *Alaska Packers' Association* v. *Domenico* (1912) 117 F. 99: see *ibid.*, Chap. 4, p. 89, at 91-92 and 96-98.

he can well judge whether the consideration is adequate and the court is not justified in interfering. All of his expositions addressed in this way support the view that the law of contract ensures that each contracts with the other voluntarily in a perfect market with all parties having full knowledge so as to increase and maximise their private and social wealth.[199]

4.2.2 Disregard of Perfect Market and Perfect Information: Radical Version

On the other hand, Posner's Kaldor-Hicks-based wealth maximisation is preposterously advocated in that it maintains that any unfair result, howsoever caused (including one caused by ignorance), of a contract has no justification to be rectified and needs to be ignored. It is to be recalled that Kaldor-Hicks-based maximisation has losers (the worse off) in contemplation but holds that if gains on the part of the better off are greater than losses on the loser's side such as to be able fully to compensate the loser, the result is still efficient (in the sense of bringing about maximised wealth) and needs no interference. Posner strongly insists that hardship suffered by the loser in any contract should not receive concern of the law. Notably, although Posner, in his invocation of the fundamental principles of economics, agrees that resources tend to gravitate towards their most valuable uses if a *voluntary exchange*—a market—is permitted,[200] he asserts that wealth can be increased and maximised *even out of an involuntary exchange* and to maximise wealth in this fashion is efficient and justifiable. In his words, "if we insist that a transaction be truly voluntary before it can be said to be efficient—truly voluntary because all potential losers have been fully compensated—we shall have very few occasions to make judgments of efficiency, for

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[199] Beyond the unconscionability area, Posner's wealth maximisation can also well apply to other areas of contract law. For instance, it can be applicable to the issue of efficient breach and efficient damages. If A (the seller) breaches his contract with B (the buyer) since he receives an offer from C (the second buyer) to buy the goods already sold to B, and by selling them to this second buyer A can earn so ludicrous profit that after applying the gain to pay expectation damages to B the seller can still be better off, this breach is efficient—all parties' wealth is increased and maximised: see for example, Posner, *Economis Analysis of Law*, *op. cit.*, (footnote 9, *supra*), Chap. 5, pp. 27-38, in particular at 31-34; Cooter and Ulen, *Law and Economics*, *op. cit.*, (footnote 10, *supra*), Chap. 7, p. 248, at 289-293.

[200] See p. 88, *supra*.

very few transactions are voluntary in that sense".[201] This contention is a radical version of his application of wealth maximisation and is out of line with the notion of controlling unfair terms in contracts. Posner's firm insistence on the disregard of contractual unfair results is best seen in his following passage in which he argues against the doctrine of unconscionability embodied in the United States Uniform Commercial Code:[202]

> "One is led to question whether the concept of unequal bargaining power is fruitful, or even meaningful. Similar doubts are raised by the vague term "unconscionability", a ground of contract discharge in the Uniform Commercial Code. If unconscionability means that a court may nullify a contract if it considers the consideration inadequate or the terms otherwise one-sided, the basic principle of encouraging market rather than surrogate legal transactions where (market) transaction costs are low is badly compromised. *Economic analysis reveals no grounds other than fraud, incapacity, and duress (the last narrowly defined) for allowing a party to repudiate the bargain that he made in entering into the contract.*"

4.3 Fallacies of Radical Version of Posnerian Wealth Maximisation

In justifying his wealth maximisation criterion, Posner lays much emphasis on the "consent argument". He claims that any transaction can be beneficial even to the party who incurs loss and it is on the basis of this benefit that the loser's consent has been found. The benefit, Posner further espouses, is in the form of "compensation *ex ante*" in the following sense: wealth which is increased and maximised through the gain on the gainer's side will in the long run lead to some other improvements valuable in themselves—luxury goods, leisure, comfort, modern medicine and opportunities to self-expression and self-realisation. As long as these are all major ingredients of most people's happiness, wealth maximisation is instrumental to the general utility or happiness of the members of society as a whole including the loser in the transaction concerned.[203] This argument is often referred to as the "*instrumentalist argument*" or

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[201] *Op. cit.*, (footnote 9, *supra*), p. 15.

[202] *Ibid.*, p. 116 (italics added).

[203] *Ibid.*, pp. 15-16. His instrumental claim can also be found in his "*Utilitarianism, Economics and Legal Theory*", *op. cit.*, (footnote 192, *supra*) in which he mentions the development of "other attractive features" resulting from the increase and maximisation of wealth.

sometimes alluded to as the "*interest argument*".[204] In reality, the consent argument, instrumentalist argument and interest argument can be merged into the same argument: consent argument. The convergence operates this way: since wealth maximisation is instrumental[205] to happiness, it is in the interest of everyone and thus everyone consents to it.

Relying on the consensual basis, as Posner does, to justify wealth maximisation is seriously debatable in the context of unfair contracts. It is largely unimaginable that the party on whose side contractual hardship solely falls had initially consented to the one-sided wealth on the part of the other party with an eye to obtaining some notional benefits *via* some invisible hand. Apparently, those making a contract are unlikely to trust that losses caused by the contract will be compensated *ex ante* by any long-run improvements or attractive features as overstated by Posner. In the real world, all tend to look first for the achievement of some immediate ends in their contracts.[206]

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[204] See for example, Coleman, "*Efficiency, Utility, and Wealth Maximization*", *op. cit.*, (footnote 17, *supra*), at 222; Dworkin, "*Why Efficiency?*", *op. cit.*, (footnote 194, *supra*), at 580-584, 275-283; Dworkin, "*Is Wealth a Value?*", in *A Matter of Principle*, (Clarendon Press Oxford, 1985), pp. 249-259.

[205] In fact, Posner is not the only economic-minded lawyer who believes in this instrumentality. There may be different versions of the instrumental claim. Some believe that any increase in wealth will necessarily and automatically result in other improvements (which will also improve the position of the worse off) through some invisible hand process. Others who are less radical argue only that the increase in wealth will not automatically cause those improvements for the benefit of the worse off but, once wealth increases, the society which receives that increment is in a better position to use it to produce other improvements and reduce poverty of the worse off. Therefore, wealth maximisation is worth pursuing nonetheless. It is not clear cut which version Posner's belief rests upon. It is worth saying, however, that Posner's wealth maximisation is somewhat of utilitarian character, for he believes that the loser must sacrifice for the greater improvements.

[206] The famous passage Posner addresses in demonstration of his consent argument is one in which he asserts that if a person buys a lottery ticket and loses the lottery the person has consented to the loss, for the uncompensated loss is fully compensated *ex ante*. In denial of this consensual claim, Coleman and Dworkin share the same view that people have consented to the *risk* of loss, but not to the *loss* itself: see Coleman, "*Efficiency, Utility, and Wealth Maximization*", *op. cit.* (footnote 17, *supra*), at 535; Dworkin, "*Why Efficiency?*", *op. cit.*, (footnote 194, *supra*), at 576. In effect, it seems indiscernible that a person who has consented to the risk of loss has not also consented to the loss likely to arise from such risk. Thus, the accurate response to the lottery illustration above should be that the consent argument works well in that lottery saga but fails in the context of unfair contracts.

It is noted that when Posnerian Wealth Maximisation first appeared in his article "*Utilitarianism, Economic and Legal Theories*",[207] his application of this proposed efficiency criterion was obviously intended to be restricted to *the creation of wealth by initially designing legal rules which would have the effect of most saving transaction costs*. According to Posner, if market transactions were costless, the process of voluntary exchange would costlessly allocate the right to whoever values the most; but the assumption of zero transaction costs is unrealistic, so that in order to reduce transaction costs and maximise wealth legal rules must initially assign rights to those who are likely to value them the most. This is what Posner calls *the "simulation of the operation of the market"*.[208] (Obviously, this is, in turn, the adoption of the "Coase Theorem" which has been earlier explained.)[209] This is evident from his later article "*The Ethical and Political Basis of the Efficiency Norm in Common Law Adjudication*"[210] where he discusses the choice of legal rules between negligence rule and strict liability rule and demonstrates that wealth maximisation predicates that negligence rule is the more efficient system since the sum of liability and accident insurance premiums will be lower under this scheme.[211] Although his advocation of wealth maximisation in this "market mimicking" sense (i.e. initially designing legal rules to reduce and save transaction costs the most) was not particularly made in the context of contracts, its application to contracts was indeed found in the earlier edition of his *Economic Analysis of Law*[212] where he asserted that value is usually increased and maximised in a voluntary transaction in a market but increasing or maximising value (wealth) in a forced (involuntary) exchange by means of regulation can be *exceptionally pursued when the transaction costs prevent voluntary transactions between individuals so that regulation of contractual rights by law can result in more*

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[207] *Op. cit.*, (footnote 192, *supra*).

[208] *Ibid.*, at 125, 127.

[209] See p. 24, *supra*.

[210] *Op. cit.*, (footnote 193, *supra*).

[211] *Ibid.*, at 403.

[212] Posner, *Economic Analysis of Law*, 2nd edn, (Little, Brown and Company, 1977).

wealth.[213] That is to say, at that time Posner viewed involuntariness permissible merely as a matter of exception.[214] His displacement to the radical approach has occurred at a later time in his current edition of "*Economic Analysis of Law*".[215] Unfortunately, it is largely fallacious and represents retrogression rather than improvement.

With regard to the Posnerian extreme approach, another point which deserves alteration is that Posner's presentation of his Kaldor-Hicks-based wealth maximisation efficiency in defiance of the notion of policing hard bargains is not fully worked out and appears incomplete. The situation in which the loss suffered by a consumer exceeds the gain the firm obtains from unfair terms in the contract is not unheard of. In such a case, the decrease in wealth of the worse off is greater than the increase in wealth of the better off and it is simply impossible fully to compensate the loss of the worse off. It follows therefore that allowing unfair terms in this situation is not the maximisation but the impairment of wealth as a whole. If Posner's appeal for wealth maximisation in rejection of the control of contractual unfairness is intended to extend to this type of case as well, Posner's argument appears largely contradictory.

4.4 Radical Version Wealth Maximisation's Linkage with Remedy through Taxation

So far, our disapproval of the extreme account of wealth maximisation in relation to unfair terms in contracts surrounds its failure to prove the aggrieved party's

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[213] *Ibid.*, pp. 11-12.

[214] This is consistent with what he has addressed in his "*Utilitarianism, Economics, and Legal Theory*" (*op. cit.*, footnote 192, *supra*, at 130): "The sole basis for interference with economic and personal liberty in the wealth-maximization approach is a failure of the market to operate that is so serious that the wealth of society can be increased by public coercion, itself costly. ... But, to repeat, the imposition of duties is appropriate in the economic view *only in the exceptional case* where market transaction costs are prohibitive" (italics added). It is in this sense that Barnett remarks that an economic efficiency theory does not constitute a distinct theory of contractual obligation—that is, it is not necessarily the theory which holds that all agreements that increase the overall wealth of society are enforceable, howsoever they are entered into; economic efficiency analysis can merely focus on explaining and then designing legal rules (such as appropriate remedies) in an effort, in the real world of positive transaction costs, to reduce costs, minimise inefficiency and thereby increase wealth: see "*A Consent Theory of Contract*", *op. cit.*, (footnote 172, *supra*), at 278.

[215] *Op. cit.*, (footnote 9, *supra*).

consent. However, this stance of attack is inoperative with regard to the other class of proponents of wealth maximisation—those who do not defend wealth maximisation on the consensual basis (since they are simply aware that such consent is inconceivable) but maintain that the courts should pursue it and hold the disadvantaged party to the unfair result of the contract nonetheless. Like Posner, this class of protagonists first assume that wealth is meaningful and valuable and can be redistributed by the "invisible hand". Upon this assumption, they grant that courts should not embark upon redistribution through any policy of scrutinising contracts. Their conviction is often intimately connected with the additional belief that taxation, as part of the invisible hand process, is efficient in redistributing total wealth. The worse off can simply be benefited through taxes levied by the government.[216]

These protagonists have indeed erred in applying the "invisible hand" in the above fashion. Firstly, they are deploying the invisible hand *outside the perfect market mechanism*. In effect, the "invisible hand" notion is advocated by economists in the restrictive context of a perfect market—that the benefit an individual obtains from an exchange in a perfect market (with everyone having full knowledge) will lead to the benefit of society as a whole. Economists have never been seen promoting the idea of increasing social wealth even out of market imperfections and imperfect contracts. As Veljanovski puts it, "the beneficence of the "invisible hand" of the market will be destroyed if any of the conditions underlying the perfect competitive market are violated."[217] In this connection, it has also been exquisitely articulated by Barnett that if this economic efficiency criterion is radically pursued regardless of voluntary exchange in the market, why not simply let judges give thieves the option of obtaining title to property that they have taken from others without their consent, provided only that the thief pays court-assessed damages which are equal to the value to the victim of that property. There is no reason for a court system to be empowered to use the

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[216] For this class of theorists, see for example Charles Fried, *Contract As Promise*, *op. cit.*, (footnote 181, *supra*), p. 106; Mitchell A. Polinsky, *op. cit.*, (footnote 43, *supra*), pp. 119, 121-127 (further discussed, *infra*).

[217] Veljanovski, *The New Law-And-Economics*, *op. cit.*, (footnote 39, *supra*), p. 36.

economic efficiency analysis to outperform the market in recognising value-enhancing exchanges.[218]

Secondly, even though this off-market "invisible hand" is allowed to stand, it may not necessarily benefit the worse off in hard bargains. Those who grant that taxation, as part of the invisible hand process, can actually remedy the loss of the aggrieved party lay excessive reliance on the effectiveness of taxation in curing that loss without interfering or destroying the initial assignment of shares in individual agreements.[219] This alleged efficacy appears true at first glance but illusory on further reflection. Although it is the ideal aim of taxation to redistribute wealth by collecting money from those who earn more and transferring it to those whose holdings are small, it is unrealistic that the losers in unfair contracts can ultimately be remedied. After all, distribution of public funds is considerably dependent upon the policies of each government and the incidence of state funds being expended on policies which are more beneficial to the affluent than the destitute class is not uncommon. When unfair redistribution is on the cards at the macro-economic level and the *whole class* of the destitute might not be adequately benefited, *a fortiori* it is inconceivable that the aggrieved party as an *individual member* of society can have his loss arising from the

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[218] Barnett, "*Consent Theory of Contract*", *op. cit.*, (footnote 172, *supra*), at 281. It is also worth noting that this radical version of invisible hand and wealth maximisation yields an absurdity not only in the context of procedural unfairness encountered in this thesis. It is also unsound in the context of substantive unfairness *per se* in that if it is pursued no one can be allowed by law to indulge in his personal preference or happiness and enter into a contract in a fashion which decreases wealth at all. This is inconsistent with the genuine economic theories which respect individuals' rationality and judgment when the ability to protect their own interest is not at stake. As Coleman puts it: "there is no basis for the belief that individuals, by acting as if they were interested only in wealth, would achieve a more attractive mix of preference satisfaction than they would if they act on the basis of the complex set of preferences they have. ... It is at least plausible that individuals who act as if they desire only wealth might secure more wealth and less of other things than they would secure if they act as if they prefer all the things they in fact do": see "*Efficiency, Utility, and Wealth Maximization*", *op. cit.*, (footnote 17, *supra*), at 528.

[219] Liberalists who implore the application of taxation as a means of redistribution also claim that taxation is less intrusive than a system of contractual regulatory control designed to achieve the same end, for taxation requires only a periodic interference with the lives of individuals whereas contractual regulation represents continuous involvement in each private transaction. To this claim, Kronman's counter-argument can be given more credence: although tax is paid at periodic intervals, it represents a continuous interference with the lives of individuals since throughout the year every income-generating transaction is subject to taxes; only its payment is made later: see Kronman, "*Contract Law and Distributive Justice*", *op. cit.*, (footnote 1, *supra*), at 504.

contract *intra partes* compensated through the process of taxation. Once again, the proposal for a general rule for the control of unfair terms in contracts remains plausible and surpasses the objections raised by the proponents of the radical version of wealth maximisation efficiency.[220]

5. Disincentive Effects

It is often argued that giving the courts the power to undo contract terms will have seriously adverse effects both on the industry's incentives to produce goods and services and on the protected parties. This argument is rather superficial and is not systematically analysed. A decline in incentives on the part of firms in the market tend to materialise only in the case where the law attempts to intervene in substantive unfairness *per se*, either in the form of imposing compulsory terms for them to deal with consumers or by undoing a contract term even when both parties are satisfied with it. An example can, perhaps, be drawn again from those "add-on" clauses as in *Williams* v. *Walker* which has been discussed throughout this chapter. Had the facts in that case been that the retailer erected his business for the particular purpose of dealing with the poor residing in that particular locality and that all these destitute customers entered into the contract with full understanding of the terms and wilfully accepted those terms for the purpose of having the goods to meet the family convenience which they could not have afforded if bought from any other shops in that area, then undoing the terms in this case would most probably result in the retailer deciding to close down his shop or choosing to deal with the average or affluent class of customers instead. But a general rule for controlling terms in contracts which this thesis has been

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[220] *Cf.* Collins's argument, addressed in *op. cit.*, (footnote 29, *supra*), p. 268, that redistribution by judicial control over the fairness of contracts can be justified on the ground that the costs of implementation of this control may be, in some cases, cheaper than to redistribute wealth through taxation. This claim may have to await empirical evidence. However, Collins's assertion is much uttered in the light of strict legislative regulation of prices or imposition of compulsory requirement, as in the instance of statutory minimum wages in employment contracts or rent control over tenancies, which is the type of control possibly independent of contracting parties' satisfaction (for instance, remuneration below the statutory minimum wages is illegal although voluntarily entered into by the employee out of some blissful reason of his own). Moreover, this type of regulation may rest upon the 'externality' ground, as explained earlier. All this may posit the question whether this argument can equally apply to the context of the control of general contract terms by subjecting them to judicial scrutiny rather than by the absolute imposition of compulsory terms.

attempting to propose is not intended to operate in the substantive dimension as such but in the situation where the accession to the term concerned has been effectuated by ignorance. In the absence of ignorance, our proposed general rule maintains that the business must not be interfered and all traders are allowed to reap the profit and prosper.[221] Based upon this general rule, if traders believe that the terms on which they intend to deal with potential customers will be voluntarily chosen by those customers notwithstanding their full awareness of the drastic effects produced by such terms, those traders can still trade on those terms without fear that their contracts will be open to judicial rewriting; (and we grant that the poverty of these customers should be tackled through tax revenues). In addition, businessmen which prefer to prosper by transacting with the destitute class of customers on those less generous terms will not be compelled to adjust the terms to suit a different class of customers who prefer to pay higher prices for more generous or better terms.[222] Furthermore, although the redistributive effect results from judicial rewriting of a particular contract, it is indeed inevitable.[223] But the redistribution of wealth in this context is merely *inter partes* as long as the contractual control is directed at rectifying hardship suffered by the parties to the contract in question only. This account of control is not one for rectifying inequality of income at the macro-economic level in the sense of compelling a transfer of funds from the rich to the poor *across the board*—the approach by which business

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[221] Frank H. Stephen, has expressed his concern that the courts might not be situational sensitive when dealing with allegedly unfair terms in standard-form contracts: see his *The Economics of the Law*, (Wheatsheaf Books, 1988), pp. 176-179 (also discussing the "add-on" clause). In this connection, it can be seen that the notion, as proposed by this thesis, of controlling contract terms along the line of leaving substantive unfairness *per se* intact satisfies this situational sensitivity.

[222] Kornhauser contends that prescription of terms is a more suitable means of intervening than undoing contract terms on a case-by-case basis since if remedies are directed at the parties rather than at the market as a whole, persons who do not prefer to purchase because of low quality or less favourable terms will have no cause of action. In Kornhauser's view, the state should prescribe standard terms for firms to deal with all customers: see "*Unconscionability in Standard Forms*", *op. cit.*, (footnote 79, *supra*), at 1179-1182. This view is seriously objectionable in terms of adverse impacts on the industry's incentives. Although prescription is desirable in some instances (for example, in the instance where the prevention of externality effects calls for it), it cannot be accepted to be generally pursued.

[223] See Kronman, "*Contract Law and Distributive Justice*", *op. cit.*, (footnote 1, *supra*). See also Collins, *op. cit.*, (footnote 29, *supra*), p. 271.

incentives may be on the ebb. The claim that this form of judicial control will mar the industry's incentives fails for these reasons.

From the perspective of those the law seeks to protect, their preference will be ruined by judicial rewriting only when the courts go far to rectify even the terms which are in their interest and which they have preferred to accept, in which case the rectification is one of the substantive unfairness *per se*. In *Williams* v. *Walker*, if the facts had still been as supposed in the preceding paragraph, annulling the "add-on" clauses would deprive the consumers of the chance to afford household appliances at cheap prices. But where consumers acceded to such terms out of their ignorance but for which they would not have agreed, those consumers would be most likely either to choose to pay a higher price to avoid the drastic effects of the terms or to look for alternative sellers in the market. It is indiscernible that the control policy which is based on ignorance will harm protected parties themselves.[224] In this connection, Polinsky concedes that in contractual disputes legal rules often will have little or no effect on the distribution of income since the party who is intended to be better off as a result of such distribution may not actually be made better off, for the other party whose benefit is lost through this distribution will attempt to have this loss compensated by demanding a higher price. Given this, Polinsky views taxation as a more efficient means to promote distributional equity in private agreements. [225] Obviously, the truth of this view can, nonetheless, be restricted to the context of the control of substantive unfairness *per se*.

6. "Disclosure" and "Plain Language" Arguments

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[224] Kennedy, in his article "*Distributive and Paternalistic Motives in Contract and Tort Law, With Special Reference to Compulsory Terms and Unequal Bargaining Power*", (1982) 41 Maryland L.R. 563, also expresses his concern that the contractual policing by the imposition of compulsory terms on contractual parties may impoverish the parties and have an adverse impact on the industry's incentives if those terms are not desired by both parties: *ibid.*, at 609-604. The similar concern is shown by Trebilcock: *see An Economic Approach to the Doctrine of Unconscionability*", *op. cit.*, (footnote 44, *supra*), pp. 414-416. In this regard, it is to be reminded that this thesis only proposes the contractual control by allowing the courts to rectify unfair terms accepted by the aggrieved party as a result of his ignorance, not by means of any absolute ban or imposition of compulsory terms in individuals' contracts. Therefore, this line of trepidation does not override our proposal.

[225] Polinsky, *An Introduction to Law and Economics*, *op. cit.*, (footnote 43, *supra*), Chap. 15, p. 119, at 121-127 and also Chap. 2, p. 7, at 9-10.

Supplications for the duty of disclosure of material facts including the implications of complicated contractual terms have increasingly been found in this decade. This appeal is made in two dimensions. First, legal scholars merely advocate, either directly[226] or indirectly[227], that the law should impose on each contracting party

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[226] Hugh Collins represents this class of advocates. In his book: *The Law of Contract*, *op. cit.*, footnote 29, *supra*, Collins strives to articulate a novel treatment and interpretation of contract law, the treatment which, on the whole, is a socialist account. Based on this account, legal rules or doctrines serve not only to establish market transactions as vehicles for individuals to acquire meaning for their lives but also to control those market transactions for the sake of public goods and collective interests when injustices arise from free market. This is, Collins asserts, the modern law of contract which, prompted by market failure, supersedes radical freedom of contract or individualism and applies to social market. The core of this modern law consists of three main themes, viz, (1) power; (2) fairness and (3) co-operation which function in the following sense. Although the law generally allows individuals to contract with others by voluntary choice to pursue meaning in their lives, state power needs to be used to facilitate and also reinforce their pursuit in the market. Additionally, although the law tolerates disparity in exchange, it needs to uphold fairness where reciprocal promises are illusory or significantly objectionable; and, also, the law must impose certain duties of co-operation in the formation and performance of contracts: see *ibid.*, Chaps 1 and 2. It is the imposition of duties of co-operation which is central to the thesis's discussion here. Collins advocates that these duties should consist, *inter alia*, not only of the duty to refrain from misleading statements but also of the duty to disclose information. In the context of pre-contractual negotiations, Collins suggests that although non-disclosure of information about *the circumstances surrounding the transaction* (namely, commercially valuable information) can be justified on the ground of the protection of incentives to acquire it, information about *the terms of the proposed contract* should be disclosed: *ibid.*, Chap. 8, pp. 187-192. See also p. 100 and footnote 228, *infra*. For his discussion of disclosure of information in the context of the performance of a contract, see *ibid.*, Chap. 13, pp. 306-309 in particular.

It is noted that although Collin's conception of modern law appears largely prompted by market failure, it is also influenced by the Welfare State political notion. He addresses that one of the major social goals of twentieth-century Western societies has been the relief of hardship and poverty through the Welfare State and, for this purpose, the states attempt to satisfy everyone's basic needs by, in general contexts, placing greater emphasis upon fairness in the distribution of wealth to provide the necessary conditions and by, in the law of contract, giving greater impetus to the themes of control of unjustifiable power and fairness in exchange: *ibid.*, pp. 31-32.

[227] See for example, J.W. Carter and M.P. Furmston, "*Good Faith and Fairness in the Negotiation of Contracts*", Part I in (1994) 8 J.C.L. 1 and Part II in (1994-1995) 8 J.C.L. 93. Carter and Furmston have discussed the duty to disclose information as part of their discussion of a duty of good faith *in the context of pre-contractual negotiations*, as contrasted with good faith *in the performance or enforcement*, in both English and Australian law. The authors seem to perceive that in the context of pre-contractual negotiations, the "good faith" issue may involve two situations, viz, (1) where a party does not disclose material facts or tells untrue facts to the other party and (2) where a party unilaterally breaks off negotiations at the stage in which one may legitimately rely on the conduct of the other and the reasons for the break-off are ones pertaining to self-interest rather than ones associated with *bona fide* disagreement concerning the terms of the contract to be entered into. Although the authors do not directly argue for the introduction into the law a duty of good faith in this context, they have demonstrated that several doctrines under existing common law (and some statutory provisions)—for instance, the doctrines of misrepresentation, promissory estoppel, restitution or undue enrichment (*quantum meruit*), collateral contract, implied contract—have served to promote good faith in contractual negotiations. Insofar as the duty to disclose is concerned, the

the duty to disclose information to the other in the process of contractual negotiations, without going further to reject the notion of empowering the courts to scrutinise contract terms. The other class of academics, on the other hand, have argued that the obligation to disclose information not only should be imposed by law but should also banish the necessity of entrusting the judiciary to undo terms in a contract. It is the latter dimension which is at variance with the proposal made in this thesis.

The reason often proffered for the requirement of disclosure, in the light of complex contractual terms,[228] is the enhancement of the efficiency of the market in the sense that disclosure will enable comparisons between contractual terms as well as minimise the possibility of consumers entering into less beneficial, or even disadvantageous, agreements.[229] Although the argument, may seem apposite at first sight, the practicality of this type of disclosure is doubtful in view of modern trade and markets. The speedy nature of transactions renders it unrealistic of firms to give consumers full explanations of the effects of all lengthy terms contained in their form-pads. In effect, this observation is found in case law as well.[230] In addition, requiring a

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authors concede that while civil law jurisdictions may have developed this duty under the guidance of tort law—in the sense that a pre-contractual relationship was conceived of as creating a duty of care—it is questionable whether the common law tort of negligence which is primarily based on the neighbour principle should be widen to respond to a lack of good faith. Notwithstanding, the authors view this as a legislative question rather than a judicial issue. The inference may, arguably, be drawn from all this that the authors have indirectly appealed for a duty to disclose material information in the contractual negotiations: see *ibid.*, at 96, 97. However, it has not been mentioned whether this can also extend to the disclosure of the implications of contract terms. See also Swan, *op. cit.*, (footnote 87, *supra*), at 26.

[228] Since disclosure of information, in pre-contractual negotiations, can be classified into disclosure of information relating to circumstances surrounding the transaction (commercially valuable information) and disclosure of information about the terms of the transaction, it should be reiterated here that the discussion of disclosure here is limited to that of the implications of convoluted contract terms only.

[229] See, for example, Hugh Collins, *op. cit.*, (footnote 29, *supra*), pp. 187-192.

[230] For example, Dillon J. has conceded, in *Walker* v. *Boyle* [1982] 1 All E.R. 634 at 644-645 that a party cannot be regarded as knowing and understanding contract terms when the transaction has been made with the assistance of a lawyer because it is unrealistic of a lawyer to draw his client's attention to the implications of all lengthy conditions. This case will be discussed in Chapter 3. However, this thesis concurs with Dillon J.'s observation only in the context of a firm dealing with a consumer since it is submitted that in the lawyer-client context a detailed advice is essentially implied by the nature of an advice contract itself, with the consequence that a lawyer should be under the obligation to provide detailed explanations to his client as regards the terms of the contract in relation to which he is advising.

firm to go clause by clause in this fashion will apparently give rise to substantial transaction costs, which the design of legal rules normally seeks to avoid before those rules can be regarded as efficient. Therefore, a more plausible solution is the judicial scrutiny of contract terms.[231]

A closely related argument is addressed that the problem stemming from consumers' failure to understand complicated terms can simply be solved by the requirement that firms employ simple and plain language in their contracts with consumers. Although the merit of this requirement is not disputed generally in the context of consumer contracts (and, unlike the case of disclosure above, its compliance scarcely appears unrealistic), it can hardly preclude the necessity of giving the courts the general power to police contract terms. This is because mere requirement without remedy attached to it in the event of non-compliance is no difference from no

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[231] In Australia, the courts have developed the common law to impose the duty of disclosure even in a contract of guarantee or a mortgage to secure a guarantee, which is not a *uberrimae fidei*. This was prominently proclaimed in *The Commercial Bank of Australia Ltd.* v. *Amadio* [1982-1983] 151 C.L.R. 447 at 455, 458. Gibbs C.J. declared that the party in such a contract must disclose "unusual features" relating to the transaction otherwise it would constitute an implied misrepresentation. He, deriving his judgment mainly from Lord Campbell's speech in *Hamilton* v. *Watson* (1845) 12 Cl. & F. 109, 8 E.R. 1339, has further clarified that what constitutes unusual features is 'anything that might *not naturally be expected* to take place between the parties in that transaction' and that in a contract of guarantee or mortgage to secure it, the following facts are not unusual features, for they are well expected to occur before a guarantee is demanded by the bank: the fact that the original debtor's account with the creditor-bank is overdrawn; that the bank is not satisfied with the debtor's account; or the fact that the debtor is in grave financial difficulties. However, the principal unusual feature found in this case was, *inter alia*, the fact that *a condition of the arrangement required the debtor's overdraft to be reduced and cleared within a very short periods* (*otherwise the bank could enforce the guarantee*). Gibbs C.J. set aside the guarantee in question on the ground of non-disclosure. If this decision is expanded from its *ad hoc* basis (i.e. the context of guarantees or mortgages) to apply to general contracts in the market including those concluded in haste and if complex terms of a contract are perceived as unusual features, the impracticality of disclosure comes into play again. The requirement of disclosure as announced in *Amadio's* case should, therefore, be regarded as being enlivened by the exigency of the particular case itself. The mortgage to secure a guarantee in question was executed without transaction haste. The staff of the bank visited the mortgagors at their home to obtain their signatures. Moreover, this case also involved an unfair advantage unconscientiously taken of a special disability of the mortgagors. The mortgagors were elderly migrants who, born in Italy, had a limited mastery of written English language, had no business experience and relied on the son for the management of their business affairs, and was misinformed by his son (for whose company's overdraft the guarantee and corresponding mortgage were executed) that the mortgage and guarantee were limited to $50,000 and to be for six months. This special disability and misrepresentation were known to the staff. Thus, the majority of judges set aside the transaction on the ground of an unconscionable bargain: see [1982-1983] 151 C.L.R. 447 per Mason J. at 466 and per Deane J. at 476, 477. See also Chapter 2 for the discussion of this case on another issue—liability attributable to constructive notice of legal wrong committed by a third party towards the other contracting party.

requirement at all. It might be argued that the law can provide for remedy by allowing a contracting party to set aside the whole contract or only the clauses he failed to understand once it appears merely that those terms are not in plain language. In this way, the argument goes further, the courts have to look merely at the "presentation" of the terms without need to interfere with freedom of contract by scrutinising their "substance". This argument is fallacious for as much the same reason as one previously expressed in response to the will theory.[232] It should be recalled that amongst those terms which are couched in prolix and complex language and consequently not understood by a contracting party, not all of them produce unfair results to that party. It will be odd and also promote a floodgate of vexatious litigation if a party is allowed to escape his contractual obligations merely by alleging that the term, although advantageous to him, is not in plain and simple language. The substance of a contract term, therefore, cannot be ignored before the court can strike it. Notably, even if the above anomaly can be solved, it may be argued, by providing that breach of the "plain language" duty can entitle the other party to annul the contract term *insofar as it is unfair in the result*, then it yields an indifferent result from initially giving the courts the general power to police contract terms on the ground of ignorance since the courts will have to make the determination as to unfairness alike. By parity of reason, even when the law chooses to provide remedy for breach of the requirement of plain language by way of damages, this can, in no wise, dispel the necessity of assessing the unfair character of the term concerned, for the quantification of damages must be made by reference to the substance of the term which results in loss to the contesting party. Therefore, it proves more expedient to give the courts the power to annul or amend contract terms at the outset. (Obviously, these considerations can apply with equal force to the context of disclosure discussed above as well.) The requirement that contract terms be in plain and legible language should be adopted, if at all, as a supplement to, not as a preclusion of, the judicial scrutiny of the terms of a contract.

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[232] See p. 67, *supra*.

V: CONCLUSION

Market imperfection involving contracting parties' ignorance about the terms contained in written (in most cases, standard form) contracts can also be perceived of as procedural unfairness. This ignorance is commonly envisaged in three forms: ignorance of the existence of inconspicuous terms; ignorance of the existence of contract terms due to the absence of opportunity to ascertain them; and ignorance of the implications of incomprehensible terms. As a result of either, or a combination, of these forms of ignorance, contracting parties have agreed to unfair terms which they would never have accepted but for the ignorance in question. It is the omnipresence of these scenarios of ignorance that calls for a general rule which empowers the courts to scrutinise fairness of the terms in contracts. Justifications for this control policy are, therefore, not simply founded on such morality-related grounds as social appeal for fairness[233] or altruism, but can be systematically analysed by reference to both economic theories and contract theories.

The concept of policing contractual terms concluded as a result of ignorance has often been challenged as being at variance with economic theories; but, from the grasp of economic concepts, it has been found that economic theories themselves can be a strong, perhaps the best, support of such a notion. The meticulous analysis of the "will theory" can also justify rectification of contractual terms generated by this type of procedural unfairness. Furthermore, the "objective theory" of contract and other closely related theories have found no room to be applied in the direction of holding ignorant parties to unfair terms in their contracts unless they make the contracts in question in the course of trade or business. The radical version of "wealth

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[233] The invocation of such ground is found at least in Atiyah when he addresses that one can see everywhere that people are appealing for a "fair deal", "fair wages", "fair prices", "fair rents" and so on and that concern for fairness of this kind is today deeply embedded in most Western societies: see "*Contract and Fair Exchange*", *op. cit.*, (footnote 4, *supra*), pp. 331-332. See also Collins' account described at footnote 226, *supra* and Barry J. Reiter, "*The Control of Contract Power*", *op. cit.* (footnote 78, *supra*), at 356 where he says: "given that society has reacted so strongly to control contract power... , it would be most surprising to find that the substantive reason underlying the available authority should point towards a law of contract devoid of any notion of control of contract power". To do justice to these writers, it must be stated that they do not justify the control of contract power on that type of ground alone. Like other writers, market imperfections appear to be invoked as their important reason: see for example, Reiter, *ibid.*, at 351.

maximisation efficiency", which claims that the loss of the contracting party will be compensated *ex ante* or by some other improvements caused by the "off-market invisible hand" process, is unrealistic and appears fallacious. This type of unfairness largely falls outside the coverage of the traditional common law and equitable doctrine of unconscionable bargains is of no assistance. Yet, statute provides no adequate remedies to ignorant parties. Given the omnipresence of contracting parties' ignorance in most transactions in the market, it is no longer appropriate for the intervention to be on a selective basis. Thus, inasmuch as the requirement of disclosure of implications of contractual terms runs counter to trade practicality, a new general rule is needed to effectuate, on the across-the-board basis, judicial review of contract terms in a written agreement, be it standardised or not, when it has been executed out of ignorance on the part of the contestant party. Also, the "plain language" requirement is not to be adopted to the preclusion of this general rule. Notwithstanding, in respect of ignorance caused by incomprehensibility, the level of ignorance which deserves legal protection should be restricted to the inability to understand such terms as general people of average intelligence do not understand.

In Chapter 2, the judiciary's attitudes towards an unfair result of a contract will be looked at in greater detail. This will be followed by the critical examination, in Chapter 3, of the Unfair Contract Terms Act 1977 with a view to gaining insights into the appropriateness or inappropriateness of the legislative framework applied. Fuller insights regarding the patronising policy will be obtained from Chapter 4 where this thesis investigates the American statutory doctrine of "unconscionability" which is embodied in the U.C.C § 2-302 and has played a pivotal role in amending or nullifying harsh terms before the courts in the United Stated. The following Chapter will critically discuss the framework introduced by the EC Directive on Unfair Terms in Consumer Contracts which has now been implemented in England and become part of English law of contract. Shortcomings to be reflected in these legislative frameworks will provide an avenue for the suggestion of appropriate reform, the subject to be dealt with in the final Chapter of this thesis.

CHAPTER 2

THE ENGLISH JUDICIARY'S RESPONSE TO UNFAIRNESS IN CONTRACT TERMS: COMMON LAW POSITION

I: INTRODUCTION

It has often been stated[1] that the English common law of contract has had no concern with fairness in the terms of a contract made between the contracting parties since the law has firmly adhered to the notion of freedom of contract. It is purely the duty of each party to look after his own interests when making a bargain. All these statements apparently gain support from the doctrine that the courts will not inquire into the adequacy of consideration in a contract. The law presumes that the parties are capable of "appreciating their own interests and of reaching their own equilibrium".[2] The doctrine has been laid down and reiterated by a long line of authorities; in particular, in *Thomas* v. *Thomas*[3] where the court upheld the agreement between the wife and the husband's executor whereby the executor agreed to allow the wife to occupy the deceased husband's house on the payment of £1 a year.[4] The alleged relationship between this doctrine and the disregard of the unfairness in contractual terms is reflected at least in the expression found in Cheshire, Fifoot and Furmston's work:[5]

> "By this (the fact that the courts will not examine the adequacy of consideration), it is meant that they will not seek to measure the comparative value of the defendant's promise and of the act or promise given by the

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[1] See, for example, G.H. Treitel, *The Law of Contract*, 9th edn., (Sweet & Maxwell, 1995), p. 384 where it has been expressed, contrasting the American approach, that it is hard to imagine an English court holding that a consumer could keep goods after paying only part of the price simply because the seller's profit on the full contract price could be excessive.

[2] Cheshire, Fifoot and Furmston, *Law of Contract*, 12th edn., (Butterworths, 1991), p. 81.

[3] (1842) 2 Q.B. 851.

[4] For other examples, see generally cases of antiquity discussed in this chapter, pp. 108 *et seq.*, *infra*. See also *Griffith* v. *Spratley* (1787) 1 Cox. 383, 29 E.R. 1213 (discussed later in this chapter, p. 115, *infra*); *Haigh* v. *Brooks* (1839) 10 A. & E. 309, at 320 (discussed at p. 129, *infra*); *Midland Bank & Trust Co. Ltd.* v. *Green* [1981] A.C. 513, at 532.

[5] *Op. cit.*, (footnote 2, *supra*), p. 81 (italics added).

> plaintiff in exchange for it, *nor will they denounce an agreement merely because it seems to be unfair*. The promise must, indeed, have been procured by the offer of some return capable of expression in terms of value."

This chapter, skeptical of the claim that the judiciary has totally ignored unfair consequences of individual agreements, will investigate in more detail English courts' genuine attitudes towards the upholding of fairness in the terms of a contract. A division between the pre-mid-twentieth century position and mid-twentieth century onwards position will be made for the purpose of demonstrating the development influenced by economic concepts. It will be explained that in the absence of misrepresentation, duress and undue influence, the courts before the mid-twentieth century did not attack unfairness in the end result of a contract as a matter of general rule and, instead, attempted to rectify, through the so-called doctrine of constructive fraud, only unfair terms which arose out of the advantage-taking by one contracting party of circumstances of weakness of the other. The remaining part will demonstrate how the courts in the twentieth century become more concerned with fairness in the outcome of an exchange. In particular, the saga arising out of *Lloyds Bank* v. *Bundy*[6] will be fully discussed with a view to providing an insight into the court's attempt to move towards the "general principle" which this thesis believes was *primarily* concerned with the maintenance of fairness in the *terms* of individuals' contracts. However, the prime objective of this chapter is ultimately to point out that notwithstanding the courts' increasing anxiety about unfairness in the terms of private bargains to the extent of once even attempting to formulate the "general rule", this judge-made law remains insufficient as long as it still requires the element of "*victimisation*", that is to say, the *advantage-taking* by one party of the lack of choice on the part of the other. The nowadays common unfairness—unfair terms caused by informational asymmetry without necessarily the presence of victimisation—is unremedied under common law and it is this deficiency that necessitates the introduction of a general rule allowing judicial review of contractual provisions. Let us examine these *in seriatim*.

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[6] [1974] 3 All E.R. 757.

II. THE PRE-MID-TWENTIETH CENTURY POSITION

1. Overview

The maxim "freedom of contract" is the product of the adoption of the economic liberalism or Laissez-Faire ideas from Adam Smith, Jeremy Bentham and other classical economists. Before these ideas emerged near the beginning of the nineteenth century, the courts' reactions towards unfairness in the terms of agreements seemed difficult to identify. It should be noted that it is not until the advent of the nineteenth century—the time when Laissez-Faire notions began to gain their substantial interest—that English courts established substantive rules and principles in the law of contract. The principles concerning "offer and acceptance", for instance, found its first emergence in *Adams* v. *Lindsell*[7] in 1818. From the mediaeval time through the sixteenth, seventeenth and eighteenth centuries, the courts played no role of formulating principles to govern private bargain, nor were they seen as actually thinking of freedom of contract. However, people, by their nature, made an exchange and bargained with others and the courts responded to this natural conduct merely by formulating "forms of action" by which an individual who suffered breach of promise given by another could bring the case to the court to enforce the promise.[8] It is the lack of substantive rules or principles governing individual agreements that may seemingly hinder the feasibility of drawing the inference of the judiciary's attitudes towards unfairness in contractual terms, for the simple reason that at that time the substantive law itself was not generally found.

Fortunately, despite the general absence of the courts' formulation of substantive law on contract, there appeared at least two doctrines—the doctrine of consideration and the doctrine of constructive fraud—which can be, in some measure, indicative of how fairness in contract was felt by the judiciary of those centuries.

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[7] (1818)1 B. & Ald. 681, 106 E.R. 250.

[8] There were various forms of action ranging from an "*action of covenant*", an "*action of debt sur contract*" to the "*action of assumpsit*" which then became the most common action for enforcing a promise in those days. For details, see Cheshire *et al, op. cit.*, (footnote 2, *supra*), Chap. 1, pp. 1-7 and the bibliographical note therein.

2. Doctrine of Consideration

The courts of those days viewed a contract made not under seal (i.e. an informal contract) as a bargain and, to them, the reason for enforcing a promise was that the promisee had provided some consideration on the promisee's part in exchange for the promise given by the promisor. Unlike the civil law system, mere declaration of will or intention to be bound by the promise could not be a sufficient ground for its enforcement.

What bears direct relevance to the question of fairness in an individual exchange is the judicial firm proclamation found in some cases that even so small a consideration could be sufficient for a promise to be sued upon. In *Sturlyn* v. *Albany*[9], it was said: "*where a thing is to be done by the plaintiff, be it never so small, this is a sufficient consideration to ground an action.*" The similar speech was delivered in *Knight* v. *Rushworth*[10]: "*the smallness of a consideration is not material, if there be any.*" These early cases, which are perhaps the origin of the doctrine that mere inadequacy of consideration is not a ground for invalidating a contract, may presumably be interpreted as the courts' proclamation that unfair results in contract terms were none of the courts' business to rectify.

Professor Atiyah has, however, examined case law of this period and come to the view that this conviction is "easy but dangerous and wrong" and that the courts did not hold as such.[11] His conclusion is based on the fact that in those decided cases the promisee did not provide the promisor with too small consideration at all. In reality, the promisee, Atiyah explains, had previously provided consideration apparently commensurate with what he sought to enforce from the promisor and subsequently promised to do something as mere evidence of some previous obligation or as a sufficient ground for invoking the new action of *assumpsit*. In forming his view, Atiyah

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[9] (1587) Cro. Eliz. 67, 78 E.R. 327.

[10] (1596) Cro. Eliz. 469, 78 E.R. 707.

[11] Atiyah, *The Rise And Fall of Freedom of Contract*, (Oxford, 1979), p. 170.

refers to *Sturlyn* v. *Albany*[12] where the lessor demanded the rent from the assignee of the lease and the assignee promised to pay it when the lessor showed him the deed. Atiyah contends that albeit the court expressed that the showing of the deed was a consideration for the payment of the rent, the act was, in effect, performed merely as evidence of the previously existing lease under which the lessor had provided reasonable, not so small at all, consideration (i.e. the granting of the possession of the property).[13] Based upon this, Atiyah has finally opined that the expression that smallness or inadequacy of consideration was immaterial "had nothing to do with the fairness of an exchange" and that this expression should not be interpreted as being equivalent to the courts allowing even a grossly inadequate (too small) consideration in return for an enormously onerous consideration. In Atiyah's view, such an expression should be taken as meaning that the court was declaring that an (*ordinary*) inadequacy but not *gross* inadequacy of consideration was immaterial.[14] However, since Atiyah's alleged discovery is apparently based upon his scrutiny of only one case (i.e. *Sturlyn* v. *Albany*, above), its credibility may be at stake. This entails further investigation by this section of the present chapter of other old cases in an endeavour to see their relation to the judiciary's considerations of fairness of the terms to which individual agreements were subjected.

A meticulous analysis of case law reveals, first, that it is true that in such a case where the court said mere a trifling thing could be a perfect consideration, the consideration was in reality not too small at all since the promisee had previously provided the promisor with a reasonable consideration. A number of cases support this truism. In *Bretton* v. *Prettiman*,[15] the defendant was indebted to the plaintiff and, such debt becoming due, promised to the plaintiff that he would pay him in consideration that the plaintiff would come before a Master in Chancery and swear that the money

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[12] (1587) Cro. Eliz. 67, 78 E.R. 327.

[13] Although Atiyah has not expressly stated that the reasonable consideration provided by the lessor is the granting of the possession of the property, the context speaks for it.

[14] *Op. cit.*, (footnote 11, *supra*), p. 173.

[15] (1678) Raym. Sir T. 153, 83 E.R. 82. Also reported in 2 Keble 26, 84 E.R. 17.

was due to him. It was adjudged for the plaintiff that the plaintiff coming to take such oath was a sufficient consideration to support the *assumpsit*.[16] It is self-evident that in truth the plaintiff had previously furnished the defendant with a considerable consideration (i.e. the money lent to and received by the defendant) so that the very act of coming to swear the existence of the debt owing was mere evidence of it. In this connection, it might be argued that the money *previously* furnished to the defendant was merely a *past* consideration and thus could not support the defendant's subsequent promise to pay. But the counter-argument can be addressed that although the defendant's promise being sued upon was subsequently made to the plaintiff, that promise was so closely related to his original promise (to repay the money) which he had given to the plaintiff at the moment the money was offered to and received by him that it should be treated as the same promise as the original one, with the result that the money originally offered and received by the defendant was not, in reality, past consideration.[17]

It also appeared in a number of early cases that although the previous and subsequent promises were not so closely related as to be treated as the same promise (as in the cases above) and then the courts, seemingly mindful that the consideration which the plaintiff had previously provided for the defendant could be not more than a *past* consideration, tried to find a new consideration by holding that even a trifling act subsequently performed by the defendant could be a good and sufficient consideration, there existed in those cases some reasonable, not trifling, consideration *alongside* that

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[16] It was common that in those days a creditor in an informal agreement preferred, in order to enforce debts owed to him, an action of *assumpsit* since in this action the case was tried by jury, not by compurgation whereby the debtor would simply win the case if he could swear an oath and bring other eleven oath swearers to support his oath that he did not owe the plaintiff creditor. For details, see the references at footnote 8, *supra*.

[17] However, even if we grant that the defendant's original and subsequent promises must be treated as being separate so that the money received by him at the time of his original promise to repay would only be a *past* consideration for his subsequent promise to pay (and that fresh consideration therefor was thus the plaintiff taking an oath), we can still find another reasonable and commensurate consideration for the defendant's new promise. This was the plaintiff not suing upon the original promise and, instead, enforcing only the subsequent promise. This point will be fully discussed in the following paragraph of the text.

trifling thing even if the courts unfortunately did not make a mention of it.[18] This usually occurred in cases where the defendant promised to the plaintiff to pay a debt which a third party had owed to the plaintiff prior to the defendant's promise to pay it. An illustration can be found from *Knight* v. *Rushworth*.[19] One Mary Rushworth had entered into a bond of £200 to the plaintiff and then gave all her goods to the defendant to pay her debt. The defendant, pretending that this bond was one of £100, not £200, told the plaintiff that if the plaintiff, together with two witnesses, came before the Mayor of Lincoln to make a deposition under oath (*deponere*) that the bond was of £200, the defendant would pay the debt. After the plaintiff had done so, the defendant did not pay the debt and, in an action of *assumpsit* brought by the plaintiff to enforce the payment, contended that there was no sufficient consideration to maintain the *assumpsit*. Although the court did not express directly that the plaintiff giving money to Mary Rushworth was past consideration for the defendant's promise to pay, it may have been assumed as such without need to spell it out explicitly. In its attempt to find any new consideration for the defendant's promise to pay, the court, referring to *Albany's case* above, found that "the travail of coming before the mayor", albeit too small, was a very good consideration since, as the court reiterated, "*the smallness of a consideration is not material, if there be any.*"[20] However, despite such reiteration, there existed a real and commensurate, not too small, consideration in return for the defendant's undertaking to pay. This very consideration was the implicit forbearance from bringing an action against Mary Rushworth as long as the plaintiff sought to recover from the defendant instead. That is, the plaintiff, upon taking the defendant's promise, relinquished the right to claim the debt of £200 from Mary Rushworth in

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[18] Atiyah seems to overlook this issue. The notion of *past* consideration was declared by the courts at least in 1565 in *Hunt* v. *Bate* (1565) 3 Dyer 272a, 73 E.R. 605, in which the plaintiff bailed a servant of the defendant master and afterwards the defendant, out of his appreciation of the plaintiff's kindness, promised to pay the plaintiff all damages and costs incurred as a result of the bail. It was held that the bail was no good consideration since it was made before the promise. The court also distinguished other cases where a previous act could be a good consideration for a subsequent promise if the previous act had been done *at the request* of the promisor.

[19] (1596) Cro. Eliz. 469, 78 E.R. 707.

[20] *Ibid.*, per Anderson, at 470.

return for the right to claim the money from the defendant alone.[21] The same was true in many contemporary cases.[22] It is noted that at that date the concept of *forbearance* as consideration had already been found in the law.[23]

The truism about the existence of some reasonable antecedent or alongside consideration may at first blush lend support to Atiyah's conclusion that the courts' expression that the inadequacy of consideration was immaterial had nothing to do with the fairness in an exchange. However, on perusal, such a conclusion may be doubtful. Although it appears that such "too small" consideration was in reality preceded by a reasonable consideration or that there existed some other reasonable consideration alongside what the court viewed as being "too small" consideration, the courts in those cases seemed to have disregarded the antecedent or alongside consideration. It follows therefore that the courts intentionally declared that the trifling or too small thing such

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[21] See the similar case of *Amie* v. *Andrews* (1685) 1 Mod. 166, 86 E.R. 804, in which the plaintiff bringing witnesses to depose before a justice of peace was held a good consideration for the defendant's promise to pay his father's debt previously owed to the plaintiff.

[22] In *Fooly* v. *Prestons* (1586) 1 Leo. 297, 74 E.R. 270 where one John Gibbon was bound to the plaintiff under a written instrument, the defendant promised to pay the plaintiff £1,000 if the plaintiff would deliver to him the said writing without claiming it back. In the action of *assumpsit*, the defendant pleaded that there was no sufficient consideration and it was held that the delivery of the said writing was good and sufficient consideration. Despite the court's emphasis on the plaintiff's act of delivering that instrument, the genuinely considerable consideration on the part of the plaintiff could well be his consequent inability to claim from John Gibbon when the instrument was lost from his hands—the type of loss which was unarguably detrimental to the plaintiff—and hence his relegation to the claim against the defendant alone. Likewise, in *Mallory* v. *Lane* (1603) Cro. Jac. 342, 79 E.R. 292, it was held that the plaintiff's delivery to the defendant of two statutes of debts which the defendant's father had delivered to the plaintiff was a good consideration. It is submitted that the real consideration was the release of the father's debt and relegation to the action against the defendant alone. Also, in *March* v. *Culpepper* (1627) Cro. Jac. 70, 79 E.R. 662 the defendant's wife, being an executrix of her former husband, was bound to pay the debt of £107 which her former husband owed to the plaintiff. The defendant promised to the plaintiff that he would pay the said sum if the plaintiff showed his accounts to the two persons appointed by the defendant for inspection. Again, the real and considerable consideration for the defendant's promise to pay this £107 was his implicit forbearance from suing the executrix wife for this sum so long as the defendant was willing to pay it. See also *Gold* v. *Henry* (1616) Cro. Jac. 381, 79 E.R. 325.

[23] This was common in an action to enforce an executor's or administrator's promise to pay from the assets of the deceased debts or legacies to the person entitled thereto. Since an executor or administrator could be sued in his personal capacity, it was held that the plaintiff's forbearance to sue him in his representative capacity was a good consideration for the promise made by him: see *Trewinian* v. *Howell* (1587) Cro. Eliz. 91, 78 E.R. 349. See also A.W.B. Simpson, *A History of the Common Law of Contract*, (Oxford Clarendon Press, 1975), pp. 339-445 and S.J. Stoljar, *A History of Contract at Common Law*, (Australian National University Press, 1975), pp. 69-70.

as the taking of an oath or the production of an instrument was a sufficient consideration for the promise being sued upon. Seen in this light, the inference can be drawn that the judiciary treated unfairness in the outcome of an agreement (*assumpsit*) between the parties as immaterial.[24] Certainly, this inference may be speculative as long as there existed no straightforward case wherein gross imbalance proper (that is, imbalance without the "antecedent" or "alongside" consideration above) was explicitly enforced by the court. Nevertheless, this inference gains momentous support from the doctrine of constructive fraud, to which we will now turn to discuss.

3. Doctrine of Constructive Fraud

What can best bolster the conclusion that the judiciary in this early period had no concern with unfairness in the result of an agreement is the long-established rule laid down in cases concerning "unconscionable bargains" or "catching bargains" in those days. As early as 1682, when *Batty* v. *Lloyd*[25] was decided, the courts of Equity exercised the supervisory jurisdiction over these kinds of bargains. Originally, the courts of Equity intervened in unconscionable transactions where an heir of a family, being financially distressed but currently expectant of his family's property or inheritance in succession to his father or any other member, sold the property at a gross undervalue, or borrowed money with the undertaking to repay a much larger sum than the original loan, or otherwise transacted at such a gross disadvantage to him. In this type of case, the courts tended to set aside the transactions as a matter of what was expressed as "pernicious principle"[26]—the judicial intention to conserve the inheritance to stay in the family. Thus, the avoidance of such a transaction on this basis

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[24] Simpson points out that where disparity of value is treated as legally significant in *assumpsit*, the basis for the decision is *absence* of consideration, not *inadequacy*. The disparity of value, that is, is only relevant because it shows that there is no consideration at all: see *ibid.*, p. 147. This is, in fact, consistent with our conclusion above: unfairness in *assumpsit* is ignored. However, too little space in Simpson's work is devoted to discussing the issue of adequacy of consideration. With the exception of *Sturlyn* v. *Albany*, cases which we discuss in this chapters are not discussed there. In the work by Stoljar, the contemporary legal historian, this issue is not even attempted: see *ibid.*

[25] (1682) 1 Vern. 141, 23 E.R. 374.

[26] The explanation of this principle or policy can be found in Lord Thurlow's judgment in *Gwynne* v. *Heaton* (1778) 1 Bro. C.C. 1, 28 E.R. 949.

had too little, if not at all, to do with the judiciary's consideration of any kind of fairness in an agreement *inter partes*. However, where this type of transaction was made by a person who was in such a circumstantial distress but was not an expectant heir, the courts of equity would set aside the bargain only when it was proved that the other party *took advantage of the necessitous circumstances of the distressed party*. This was what the courts normally called *fraud*. The court clearly explained in *Earl of Aylesford* v. *Morris*[27] that here fraud did not mean deceit or circumvention but meant unconscientious use of the power out of circumstances or conditions of the parties; in other words, this is constructive fraud. At later times, the division between the expectant heir category and non-expectant heir category ceased to exist, with the result that the same approach—fraud—applied to heirs and non-heirs alike.[28] Without fraud,

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[27] (1873) 8 Ch. App. 484, at 489-491.

[28] In more recent times, this equitable doctrine and its "fraud" rationale has often been described to apply to "poor and ignorant persons". This is simply because the circumstances of weaknesses recognised by English courts as triggering the operation of equity have been confined to poverty and ignorance, without extending to other circumstances of which advantage can be taken. It is noted that although circumstances of weaknesses found in early cases appeared to involve poverty (financial distress) and ignorance (of the true value of property concerned), the rationale regarding "fraud" was also found cited by the courts in rather broad terms: see, for example, *Evans* v. *Llewellin* (1787) 1 Cox. 333, 29 E.R. 1191 at 1194 ("The cases... proceed on the same general principle...that if the party is in a situation in which he is not a free agent, and is not equal to protecting himself, this court will protect him... ."); *Earl of Aylesford* v. *Morris* (1873) 8 Ch. App. 484 at 490 ("...it is sufficient for the application of the principle, if the parties meet under circumstances as, in the present transaction, to give the stronger party dominion over the weaker, and such power and influence are generally possessed...by those who trade upon the follies and vices of unprotected youth, inexperience, and moral imbecility"). While courts of commonwealth jurisdictions, in particular Australia, New Zealand and Canada, have relied on the generality found in these English cases to expand their equivalent equitable doctrine to apply to a wide range of circumstances of weaknesses, the doctrine has been narrowed in the parent jurisdiction—being restricted to "poor and ignorant persons". An instructive Australian case is *Blomley* v. *Ryan* (1956) 99 C.L.R. 362, per Fullagar J. at 405 ("The circumstances adversely affecting a party, which may induce a court of equity either to refuse its aid or to set a transaction aside, are of great variety and can hardly be satisfactorily classified. Among them are *poverty or need of any kind*, *sickness*, *age*, *sex*, *infirmity of body or mind*, *drunkenness*, *illiteracy* or *lack of education*, *lack of assistance or explanation* where assistance or explanation is necessary. The common characteristic seems to be that they have the effect of placing one party at a serious disadvantage *vis-à-vis* the other.") and per Kitto J. at 415 ("The principle of equity applies whenever one party to a transaction is at a special disadvantage in dealing with the other party because *illness*, *ignorance*, *inexperience*, *impaired faculties*, *financial need* or *other circumstances* affect his ability to conserve his own interests, and the other party unconscientiously takes advantage of the opportunity thus placed in his hands") (italics added). For details, see Robert Clark, *Inequality of Bargaining Power: Judicial Intervention in Improvident and Unconscionable Bargains*, (Carswell, 1987); Mindy Chen-Wishart, *Unconscionable Bargains*, (Butterworth: Wellington, 1989); Steven R. Enman, "*Doctrines of Unconscionability in Canadian, English and Commonwealth Contract Law*", [1987] Anglo-American L.R. 191.

the courts would not invalidate a bargain even if the undervalue or disparity of consideration was so gross.[29] An unfair result of an agreement could only be rectified when prompted by fraud. Substantive unfairness *per se* was generally free from the judicial attack. In *Heathcote* v. *Paignion*,[30] the court attacked a very gross undervalue in such a way as to sound that the court treated the gross undervalue alone as being unfair and invalid. However, this decision was later explained by Lord Chief Baron Eyre in *Griffith* v. *Spratley*[31] that mere gross inadequacy was not in itself a principle upon which a party could be relieved from a contract and his Lordship clarified that the court in *Heathcote* v. *Paignion* only inferred or presumed fraud from such a gross undervalue (although the presumption seemed to be so tenacious that its rebuttal could hardly be successful!).[32] Undeniably, in exercising this equitable jurisdiction to set aside an unconscionable bargain, the unfairness in the outcome of the bargain (the gross undervalue price, for instance) was also eviscerated; but its evisceration was the by-product of the judiciary's attack on fraud (procedural unfairness) rather than the direct concern with substantive unfairness *per se*.

4. Exceptional Interference with Unfairness in Contract Terms

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[29] See *Earl of Ardglasse* v. *Henry Muschamp* (1684) 1 Vern. 237, 23 E.R. 438, in which the Lord Keeper said: "the over-value be it never so great is not itself sufficient ground to set aside a bargain" and *Gwynne* v. *Heaton* (1778) 1 Bro. C.C. 1, 28 E.R. 949 where Lord Thurlow expressed, at 9: "a bargain cannot be set aside upon inadequacy only. If parties are of full age, treating upon equal terms *without imposition*; and there is an inequality, *even if it is a gross one*, the court in general has not set it aside."

[30] (1787) 2 Bro. C.C. 167, 29 E.R. 96.

[31] (1787) 1 Cox. 383 at 338-339, 29 E.R. 1213 at 1215. This expression can well fortify the conclusion earlier made in this chapter that Atiyah's view as regards gross inadequacy of consideration is obviously dubious.

[32] In *Coles* v. *Trecothick* (1804) 9 Ves. 234, 32 E.R. 592, Lord Eldon seemed to perceive that where the inadequacy of price was 'such as shocks the conscience', it amounted *in itself* to conclusive and decisive evidence of fraud. The admittance of this degree of inadequacy to be conclusive evidence or presumption of fraud had, in reality, the effect of a direct attack on mere disparity of the values exchanged since the presumption was so conclusive that the rebuttal by proof that no fraud was actually present was not allowed. However, this case was a *specific performance* case, not a *recission* case. The court admitted the inadequacy which was such as shocked the conscience as a ground to refuse specific performance only. The agreement would not be set aside merely on this ground. *Cf.* American cases, discussed in Chapter 4 *infra*, which developed *Coles* v. *Trecothick* to apply to recission cases as well.

Although in general the courts persistently disregarded an unfair outcome which occurred without fraud, some cases can be found in which the judiciary attempted to rectify the substance of an agreement concluded without procedural improprieties. However, these cases are only exceptional and are not representative of the general image. As regards these exceptional cases, we find, first, that in restraint of trade cases in those days, the courts obviously attempted to uphold fairness in the end result of an agreement through the requirement that consideration given in return for a promise should not be grossly inadequate. An analysis of primitive cases in the restraint of trade context suggests that the courts required two kinds of "reasonableness" of the restraint in question; viz, (1) reasonableness to the party restrained and (2) reasonableness to the public (in the sense that the public would not be unreasonably affected or deprived of a useful member). If the restraint was unreasonable to the public, the courts would set it aside at the outset;[33] but if the public was not seriously harmed by the restraint, the courts would then move to look at its reasonableness as between the parties. According to a long line of old authorities, a restraint would be regarded as reasonable as between the parties if the restraint was made upon *a good and adequate consideration*. The rule was first so established by Parker C.J. in *Mitchel* v. *Reynolds*.[34] In this case, the plaintiff had assigned to the defendant the lease of a house in the parish of St. Andrew's Holborn for five years and the defendant entered into a bond conditioned that the defendant would not exercise the trade of a baker within that parish during that five years' term. Parker C.J. held the restraint good as it was supported by *a good and adequate consideration*.[35]

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[33] As far as the mischief which would arise from a restraint to the public is concerned, Parker C.J., in the leading case of *Mitchel* v. *Reynolds* (1711) 1 P. Wms. 181, 24 E.R. 347, laid down the rule, which has been firmly followed by subsequent cases, that a *general* restraint, namely, a restraint from carrying on a business throughout the country, not just in a given area, would always be void irrespective of consideration given in return for it. This can be understood as the court holding that such a restraint appeared injurious or unreasonable to the public and was to be invalidated even if the party restrained was provided with a reasonable consideration therefor.

[34] (1711) 1 P. Wms. 181, 24 E.R. 347.

[35] Notably, in the course of Lord Chief Justice Parker's consideration of the case before him, he sometimes said that a promise in restraint of trade would be valid if made upon *a good consideration*, as opposed to a promise made without consideration (*nudum pactum*). This may inadvertently convey the impression that reasonableness to the restrained party merely required any good consideration,

The rule (of good and adequate consideration for the reasonableness of a promise in restraint of trade) was followed by subsequent cases, especially in *Gale* v. *Reed*[36] and *Young* v. *Timmins*.[37] Also, in *Horner* v. *Graves*,[38] which concerned a covenant given to a surgeon-dentist by his assistant to refrain from the dental surgery business or profession at or within 100 miles of the city of York while the surgeon-dentist was living and practising. The court held this restraint unreasonable and void. At first, Tindal C.J., in giving the judgment, cited *Mitchel* v. *Reynolds* and thought that the consideration given in return for the restraint was "*very slender and inadequate*".[39] However, he then attempted to lay down what he believed to be a better test of reasonableness: "Was the restraint such only as to afford a fair protection to the interests of the party in favour of whom it was given (and not so large as to interfere with the interests of the public)?".[40] Upon this test, he finally held that the restraint in this case was far larger than was necessary for the protection of the surgeon-dentist as he "shut out the assistant from a much wider field than could by possibility be occupied beneficially by himself."[41] However, on analysis, his test did not totally or substantially depart from the previous test laid down in *Mitchel* v. *Reynolds*, for ultimately the

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irrespective of commensurability of that consideration and the restraint. In reality, Parker C.J. laid emphasis on the presence of an *adequate*, not only *good*, consideration. This is evident from part of his judgment where he clearly spelled out that the *raison d'être* of the requirement that a consideration for a restraint be reasonable to the restrained party surrounded "injuries" arising to the restrained party himself: see (1711) 1 P. Wms. 178 at 193, 24 E.R. 347 at 351 ("...it is always necessary to shew the consideration, so that the presumption of injury could not take place..."). Thus, if the consideration the restrained party received in return for the restraint was so trifling, it would be unreal to say that the restrained party was free from injury and that the restraint was reasonable to him. It is, therefore, essential that an *adequate* consideration be given to him. It must be stressed, however, that the court, in requiring an adequate consideration, never insisted upon an *equal* consideration; the court merely contemplated such consideration which would not be *grossly inadequate* when compared to the restraint in favour of the other party.

[36] (1806) East. 80, 103 E.R. 274.

[37] (1831) 1 C.&J. 331, 148 E.R. 1146.

[38] (1831) 7 Bing. 735, 131 E.R. 284.

[39] *Ibid.*, at 742, 287.

[40] *Ibid.*, at 743. Obviously, the phrase "not so large as to interfere with the interests of the public" only indicates the "reasonableness to the public" in addition to the reasonableness to the restrained party.

[41] *Ibid.*, at 744.

court, when considering whether the restraint was necessary for a fair protection of the restraining party, seemed to look at the adequacy of consideration given for the restraint. That is to say, if the restrained party was furnished with an adequate consideration, it would be more likely that the court would treat the restraint as necessary for the protection of the restraining party's interests. Moreover, Tindal C.J., in proposing his test, did not say that he disagreed with the previous test upon the authority of *Mitchel* v. *Reynolds*. Therefore, this test should rather be understood as being proposed only as a matter of more convenience but as inheriting the content of the previously established test. However, in 1837 in *Hitchcock* v. *Coker*,[42] Tindal C.J made an about-turn in stating clearly that the "necessity for the protection of interests" test replaced the old test (the "good and adequate consideration" test).[43] This new test was followed by subsequent cases.[44] Whatever test was proclaimed, the result remained the same; that is, the judiciary intervened in an unfair result of this type of agreement even though no procedural wrong was present. A restraint which was larger than was necessary for the protection of the interests of the covenantee was declared void notwithstanding that the covenant was given with full knowledge.

Next, the courts occasionally endeavoured to rectify an unfair result of a contract by some indirect means. The reason why the rectification was to be indirect is understandable—the courts felt that they could not depart from the main stream, i.e. the firmly-established rule that unfairness without fraud and other procedural defects could not be meddled with. The following cases afford illustrations of the application of indirect methods. In *Bowen* v. *Edwards*,[45] premises which had been mortgaged were, subsequently, absolutely sold to the mortgagee at a gross undervalue. Although the transaction was an absolute sale and no proof of fraud was made, the court, noting

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[42] (1837) 6 Ad. & E. 438, 112 E.R. 167.

[43] Here, he said: "But, if by adequacy of consideration more is intended, and that the Court must weigh whether the consideration is equal in value to that which the party gives up or loses by the restraint under which he has placed himself, we feel ourselves bound to differ from that doctrine": (1837) 6 Ad. & E. 438 at 457, 112 E.R. 167 at 175.

[44] See, for example, *Archer* v. *Marsh* (1837) 6 Ad. & E. 959, 112 E.R. 366.

[45] (1661) 1 Ch. Rep. 221, 21 E.R. 556.

the gross undervalue price, assisted the seller by holding the transaction to retain the character of a mortgage and thus decreeing a redemption. In *Zouch* v. *Swaine*,[46] an estate was also sold at a gross undervalue with a covenant by the seller for quiet enjoyment. It was found later that the title was defective and the buyer was evicted. In response to an action brought by the buyer for breach of the covenant, the seller requested relief and the court, taking into account the undervalue price, decreed the buyer only the purchase-money and interest.

Indirect means by which the courts apparently assisted the party who suffered the unfair consequence of a bargain made without fraud could also be in the form of the refusal to decree specific performance to the other party on the ground of "unconscionability" although the agreement in question could not be rescinded. In refusing specific performance, a court in *Keen* v. *Stuckely*[47] even attempted to invoke some trivial technicality. There, the seller sold his land to the buyer at a manifestly exorbitant price and, in an action brought by the seller to seek specific performance, the buyer challenged that since the price was unconscionable the seller was not to demand a specific performance of this unconscionable sale. In response, the seller contended: "*a man was obliged in conscience to perform a bargain, though it was a hard one*." The court, albeit leaving the unconscionability issue open, refused to grant specific performance, basing the decision on the ground that the seller did not make out the title to the buyer on or before the time covenanted and therefore could not entitle himself to the purchase money. Arguably, this could be discerned as a fairly technical fault.[48]

5. Prevention of Abusive Market Practices Conducive to Unfair Prices

Interestingly, although the judiciary in the early centuries generally did not, in the absence of fraud or procedural deficiencies, rectify substantive unfairness as between *the parties to each agreement*, the centuries witnessed the courts' endeavours

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[46] (1685) 1 Vern. 320, 23 E.R. 495.

[47] (1721) Gilb. Rep. 155, 25 E.R. 109.

[48] See also *Coles* v. *Trecothick*, footnote 32, *supra*.

to obliterate unfairness to *consumers in general* which could result from merchants' co-operation or conduct such as restrictive practices or monopolies. In order to obliterate it, the courts would hold those types of conduct illegal. These judicial endeavours can be visualised in a number of cases. For instance, in *R* v. *Waddington*,[49] a wise merchant, having got into his hands by buying up large quantities of hops at certain large prices, tried to engross hops so that he could resell the hops for an exorbitant profit to brewers. The engrossing was also committed by spreading a false rumour to hop-growers that the then present stock of hops was nearly exhausted and that from that time there soon would be a scarcity of hops and hop prices would consequently rise. This rumour was obviously intended to induce all hop growers as well as persons dealing in hops and having large quantities of hops for sale to abstain from selling their hops for a long time so that all brewers who needed hops for producing ale would meanwhile be unable to obtain supplies from any person and then have to buy from the merchant. The court convicted this merchant and fined him. Lord Kenyon expressed the following in his judgment.[50]

> "... if a number of rich persons are to buy up the whole or considerable part of the produce from whence such supply is derived, in order to make their own private and exorbitant advantage of it *to the public detriment*, it will be found to be an evil of the greatest magnitude; and I am warranted in saying, that it is a most heinous offence against religion and morality, and against the established law of the country. ... If he (the defendant) went there for the purpose of making his purchases in the fair course of dealing with a view of afterwards dispersing the commodity which he collected in proportion to the wants and convenience of the public, whatever profit accrues to him from the transaction, no blame is imputable to him. On the contrary, if the whole of his conduct shews plainly that he did not make his purchases in the market with this view, but that his traffic there was carried on with a view to enhance the price of the commodity, to deprive the people of their ordinary subsistence, or else to compel them to purchase it at an exorbitant price, who can deny that this is an offence of the greatest magnitude?"

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[49] (1800) 1 East 143, 102 E.R. 56.

[50] (1800) 1 East 143 at 155, 158, 102 E.R. 56 at 61, 62 (italics added). Lord Kenyon delivered a similar passage in *R* v. *Rusby* (1800) Peake Add. Cas. 189 at 193, 117 E.R. 241 at 242 where a merchant who committed the regratting (i.e.buying a large quantity of goods to be in his exclusive hands and immediately selling at a higher price) was held guilty.

Similarly, the court in *Cousins* v. *Smith*[51] held illegal the practice within "The Fruit Club" formed with a view to getting control of the fruit import trade in England. The courts seemed to foresee that after merchants, by means of this kind of practice, got exclusive control of the trade or goods, they had a high propensity of selling the goods or services to consumers at unreasonably high prices.

6. Reception of Laissez-Faire Influence

As previously mentioned, the disregard by the courts in the early centuries of unfair results of agreements between individuals had no actual connection with economic theories—the concepts which in effect emerged in a far more recent time. However, when the influences of economic liberalism and Laissez-Faire spread and penetrated to judges, the courts seemed to find it easy to accommodate these economic notions and employ them as the basis on which to refrain from intervening in an unfair outcome of a contract. These economic concepts were adopted under the principle of "*freedom of contract*". The judicial application of this principle was, at least, found in employment cases in which a worker who took up even a necessarily dangerous employment with his eyes open and in full knowledge of the accompanying risks was taken to be *volens* to the risks concerned and, when he was injured at work, was thus unable to claim damages against his employer notwithstanding that the remuneration received for the work was not commensurate with the assumption of the danger. Admittedly, the decisions on the "*volenti non fit injuria*" issue in these tort cases also bore a close relation to the courts' consideration, based on the "freedom of contract" rubric, of unfairness in an individual contract. In *Woodley* v. *Metropolitan District Railway Co. Ltd.*[52] wherein a workman who was working, in the employ of a contractor engaged by the defendant railway company, in an unlit tunnel and who was subsequently struck by the defendants' train claimed damages against the defendants, contending that the defendants were negligent in failing to provide a system to warn of the approach of trains, the Court of Appeal held that *if the workman was to be looked*

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[51] (1807) 13 Ves. 542, 33 E.R. 397.

[52] (1877) 2 Ex.D. 384.

upon as the servant (i.e. employee) of the railway company, the claim was debarred by the maxim "*volenti non fit injuria*". It was further explained that matters beyond the agreement between the parties could at best exhibit moral, not legal, obligations. This position was summed up as follows:[53]

> "If a man chooses to accept the employment, or to continue in it with a knowledge of the danger, he must abide the consequences, so far as any claim to compensation against the employer is concerned. *Morally speaking*, those who employ men on dangerous work without doing all in their power to obviate the danger are highly reprehensible, as I certainly think the company were in the present instance. The workman who depends on his employment for the bread of himself and his family is thus tempted to incur risks to which, *as a matter of humanity*, he ought not to be exposed. But looking at the matter *in a legal point of view*, if a man, for the sake of the employment, takes it or continues in it with a knowledge of its risks, he must trust to himself to keep clear of injury."

This decision was given by the majority of the Court. Mellish and Baggallay L.JJ. dissented to the outcome of the case, holding that the railway company was liable for the injury caused to the workman. However, the dissenting opinions were not at all at variance with the view, as given by the majority of judges, regarding the relationship between "freedom of contract" and fairness. Mellish and Baggallay L.JJ. were merely concerned that the workman in this case was *not* the employee of the railway company, being merely in the service of the contractor. As a consequence, there was no contractual provision to modify or take away the right of the workman to claim damages for negligence. (In this regard, it was thought by the majority of judges that even though no contract was entered into between the workman and the railway company, the workman was fully aware of danger and thus could not make the company liable.[54]) Indeed, the reasoning addressed in the dissenting judgment was a confirmation that had a direct contractual relationship existed between the railway company and the workman, the agreement would have been upheld irrespective of unfair risks to which it subjected the workman. Here it was expressed:[55]

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[53] *Ibid.*, per Cockburn C.J. at 389 (italics added). See also Mellor J's view at 397.

[54] *Ibid.*, per Cockburn C.J. at 390 and per Mellor J. at 398.

[55] *Ibid.*, at 391 (italics added).

"Now there can be no doubt that by the law of this country every person who carries on a dangerous trade is bound to take reasonable care that no other person ... suffers a personal injury from the manner in which his trade is carried on. ... This liability is not founded on contract. *It may be modified or taken away by contract* .. . In the case of a servant who enters into the service of a master who carries on a dangerous trade, the right of the servant to be protected in his person is largely modified by the contract between master and servant. The servant is considered to contract that he will run all the ordinary risks arising from the nature of his master's business ... and all risks arising from the negligence of his co-servants; *but the servant of the contractor enters into no such contract with the railway company*, because he enters into no contract with the railway company at all, and his contract with his own master is res inter alios acta, and in my opinion is altogether immaterial."

A few years later, the defence of "*volenti non fit injuria*" to a tortious act was also considered by the House of Lords in *Joseph Smith (Pauper)* v. *Charles Baker & Sons*.[56] In this case, a workman was employed by railway contractors to drill holes in a rock cutting. The work was not in itself dangerous but had to be performed in a dangerous environment since it appeared that from time to time stones would be lifted by the crane which was to be jibbed over workmen's heads. The workman was fully aware of the dangerous plight but later sued the contractors when he was seriously injured by the stones falling on him from the crane being jibbed. Lord Bramwell, like the court in *Woodley's case* above, equated the full knowledge of the risks attendant upon the work with the voluntary consent to assume them and, more interestingly, treated the situation as a pure question of bargain:[57]

> "It [the maxim *volenti non fit injuria*] is a value of good sense that if a man voluntarily undertakes a risk for a reward which is adequate to induce him, he shall not, if he suffers from the risk, have a compensation for which he did not stipulate. He can, if he chooses, say, 'I will undertake the risk for so much, and if hurt, you must give me so much more, or an equivalent for the hurt.' But drop the maxim. *Treat it as a question of bargain*. The plaintiff here thought the pay worth the risk, and did not bargain for a compensation if hurt: in effect, he undertook the works, with its risks, for his wages and no more. He says so. Suppose he had said, 'If I am to run this risk, you must give me 6*s*. a day and not 5*s*.', and the master agreed, would he in reason have a claim if he got hurt? Clearly not. What difference is there if the master says, 'No; I will only give the 5*s*.'? None. I am ashamed to argue it."

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[56] [1891] A.C. 325 (H.L.).

[57] *Ibid.*, at 344 (italics added)

On full scrutiny, Lord Bramwell tried to bring out that an agreement to undertake any dangerous work, or to work in a dangerous environment, with full knowledge of the true nature of the risk could be concluded in either of these following three ways—*either* (1) the workman was, even at the very beginning, satisfied with the pay, thinking that the pay was worth the risk, *or* (2) he, thinking that the pay offered at the beginning was not worth the risk, refused to take up the employment unless the employer increased the pay to suit the risk and the employer so agreed, *or* (3) this workman, as in (2), asked for the higher pay to suit the risk but was refused by the employer and then agreed to work for the low pay originally offered nonetheless. Lord Bramwell thought that all cases produced the same consequence, namely, the employee who made the bargain with such full knowledge of the danger involved must abide the deal and be treated as having been *volens* to the risk irrespective of whether or not the pay was worth the risk. Obviously, such an agreement as in (1) and (2) would not be discerned as unfair since the pay was worth, or increased to be worth, the risk. However, such a contract as in the situation (3) was undoubtedly unfair in its end result, for the workman agreed to be exposed to a high risk in return for low pay not worth the risk when the outcome of the negotiation for higher pay to suit the risk was negative. Nonetheless, in Lord Bramwell's view, freedom of contract weighed against the rectification of this injustice; a workman had to look after his interests by going to inspect the working place and, if it appeared more dangerous than he could accept, abandoning the proposed employment. If he did not give it up, he could not allege that the pay was cruel. In his Lordship's words: [58]

> "It is said that to hold the plaintiff (the workman) is not to recover is to hold that a master may carry on his work in a dangerous way and damage his servant. I do so hold, if the servant is foolish enough to agree to it. This sounds very cruel. But do not people go to see dangerous sports? Acrobats daily incur fearful dangers, lion-tamers and the like. Let us hold to the law. If we want to be charitable, gratify ourselves out of our own pockets."

However, Lord Bramwell's judgment was rejected by the majority ruling in this case. All other members of the House of Lords established the position that the mere fact that a workman undertakes or continues in the employment with full knowledge

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[58] *Ibid.*, at 346.

and understanding of the danger is not conclusive evidence of his voluntary consent to undertake the risk of injuries. The workman's claim for damages was successful in this case. There, Lord Watson said:[59]

> "When, as is commonly the case, his acceptance or non-acceptance of the risk is left to implication, the workman cannot reasonably be held to have undertaken it unless he knew of its existence and appreciated or had the means of appreciating its danger. But assuming that he did so, I am unable to accede to the suggestion that the mere fact of his continuing at his work, with such knowledge and appreciation, will in every case necessarily imply his acceptance. Whether it will have that effect or not depends, in my opinion, to a considerable extent upon the nature of the risk, and the workman's connection with it, as well as upon other considerations which must vary according to the circumstances of each case."

Notwithstanding, any attempt to equate this formulation with the House of Lords' insistence upon fairness in the result of an agreement in general would be far from accuracy. It is submitted that the courts tended to treat an employment contract, particularly those in the industrial context, rather differently from contracts in general. The philosophy that activities in the industrial context are closely linked to the national economy as a whole has, in a considerable measure, prompted the judicial policy that workmen should be more strictly protected against injuries.[60] In addition, economic pressures on an employee may have played an important role in triggering judicial protection in this type of agreement.[61] In effect, Parliament had earlier taken the hand

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[59] *Ibid.*, at 355.

[60] See for example, K.M. Stanton, *The Modern Law of Tort*, (Sweet & Maxwell, 1994), p. 235; *Rogers, Winfield & Jolowicz on Tort*, 14th edn., (Sweet & Maxwell, 1992), p. 220.

[61] This is, however, more prominent in modern cases in which it is said that economic constraints deprive a workman or employee of his "freedom of choice" with the consequence that his consent to assume the risk attendant upon the work undertaken is more apparent than real: see, for example, *Bowater* v. *Rowley Regis Corp.* [1944] K.B. 476 per Scott L.J. at 479; *Imperial Chemical Industries Ltd.* v. *Shatwell* [1965] A.C. 656 (H.L.) per Lord Hodson at 681, per Lord Pearce at 686; *Johnstone* v. *Bloomsbury Health Authority* [1992] Q.B. 333 (C.A.) per Stuart-Smith L.J. at 344. See also Stanton, *ibid.*, p. 111; Rogers, Winfield & Jolowicz, *ibid.*, p 735.

It should also be noted that in modern cases the rule that mere knowledge of the risk is not by itself a voluntary assumption of it has been extended to contexts other than employment agreements. Thus, it has been held that merely getting into a vehicle with a driver known to have been drinking alcohol or totally inexperienced does not suffice to establish the defence of *volenti*: see *Dann* v. *Hamilton* [1939] 1 K.B. 509 and *Nettleship* v. *Weston* [1971] 2 Q.B. 691 at 701 respectively. These decisions may obscure the historical peculiarity of this rule in the employment context. However, such extended application has now been reduced by later courts. First, it was held in *Pitts* v. *Hunt* [1991] 1 Q.B. 24 that the damages claim by the plaintiff who rode pillion a motor-cycle driven by the

in protecting workers. The courts could merely have attempted to bring common law in line with legislation in this particular context.[62] In general agreements between individuals, freedom of contract seemed to retain its prominence.

The judicial obsession with unfettered freedom of contract found its manifestation in cases in which the courts even allowed merchants to trade and cooperate in any way they pleased, although such business cooperation may ultimately have resulted in unfairness to *consumers in general*. An example can be provided by the House of Lords case of *Mogul* v. *McGregor*[63] where there appeared a cooperation amongst shipowners to secure the carrying trade exclusively for themselves. Their association was established and all members agreed to offer reduced freight rates fixed by the Association. The rates offered were so low that they were unremunerative. These rates were designed to be only temporary since their real objective was to push all competitors out of business so that the carrying trade would then be in the exclusive control of the Association (and after which new rates would be applied). The plaintiff, who used to be a member of the Association but was later excluded from it, suffered the loss and brought an action against this Association, alleging the conspiracy to injure the plaintiff. The House of Lords unanimously held in the rejection of the claim and decided that the plaintiff's loss could not be remedied. The reasoning given by all

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defendant in a dangerous manner upon the plaintiff's encouragement would have been blocked by the *volenti* doctrine but for section 149 of the Road Traffic Act 1988. More significantly, the Court of Appeal in *Morris* v. *Murray* [1991] 2 Q.B. 6 held that the embarkation on a pleasure flight in a light aircraft with a heavily drunk pilot constituted *volenti*. Although the Court of Appeal distinguished *Dann* from *Morris* by the facts that the latter involved a wild and irresponsible joint venture (the plaintiff and the defendant had spent the whole afternoon drinking heavily together before the flight) and that piloting an aircraft was a task far more complex and vulnerable to mis-judgment than driving a car in an ordinary social outing, the decision also gives rise to a presage that in general cases the knowledge of risks is now, at common law, more likely to operate *volenti*. Notably, Fox L.J. seemed to observe that the retreat of the '*volenti non fit injuria*' defence is "certainly in relation to master and servant cases": see [1991] 2 Q.B. 6, at 17. Even in *Dann* itself, Asquith J. left open the possibility that the plea of *volenti* would be applicable where 'the drunkenness is so extreme and so glaring that to accept a lift from him is like engaging in an intrinsically and obviously dangerous occupation, intermeddling with an unexposed bomb or walking on the edge of an unfenced cliff'. See also Markesinis & Deakin, *Tort Law*, 3rd edn., (Oxford Clarendon Press, 1994), pp. 658, 659.

[62] Rogers, Winfield & Jolowicz, *op. cit*, (footnote 60, *supra*), p. 733.

[63] [1892] A.C. 25.

their Lordships was that the Association had no malicious intention[64] to injure rival traders including the plaintiff and that the act was exactly the normal tactics employed in all free competition. In the court sanctioning this freedom to "cut the price" for the sole purpose of getting exclusive control of trade, the court seemed to disregard detrimental impacts on consumers in general which would occur if the merchants, after their success in the exclusive control of the trade, then raised the price beyond what could be fair. In the *Mogul's* case itself, the judges appeared to foresee this incident[65] but the court, under the robust influence of freedom of contract, tended to attach no importance to it. "It is", Lord Watson said,[66] "...idle to suggest that the legality of the mercantile competition ought to be gauged by the amount of the consideration for which a competing trader thinks fit to part with his goods or to accept employment."[67]

Actually, a mutual agreement between businessmen to maintain any fixed prices occurred in *Thorne* v. *Motor Trade Association*.[68] In this case, wholesalers and retailers were members of a trade association and, amongst them, a resale price maintenance agreement was made through the creation of a mechanism of a stop-list and a boycott whereby any retailer who sold the goods at prices below the ones fixed by the Trade Association would have his name entered on a stop-list and refused supplies by all wholesalers, who in turn, if continuing supplying the boycotted retailer or themselves selling the goods in contravention of the fixed prices, would be similarly put on a stop-list and refused supplies by manufacturers. In addition to the stop-list and boycott, breachers of the price maintenance agreement could be charged and investigated by the Council and Committee of the Trade Association which had the

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[64] The House of Lords distinguished this case in *Quinn* v. *Leathem* [1901] A.C. 495 where there was found such a malicious intention.

[65] This is evident from Lord Halsbury's expression (which in turn quoted Bowen L.J.'s language): "All commercial men with capital are acquainted with the ordinary expedient of sowing one year a crop of apparently unfruitful prices, in order by driving competition away to reap a fuller harvest of profit in the future...": [1891] A.C. 25, at 37.

[66] *Ibid.*, at 43.

[67] See also *Sorrell* v. *Smith* [1925] A.C. 700 where the House of Lords, citing *Mogul's case*, upheld the combination of newspaper proprietors.

[68] [1937] A.C. 797.

power to fine them as an alternative to the putting of their names on a stop-list. The plaintiff in this case was a member who sold the goods at a lower price than the fixed prices and thus had his name entered in a stop-list. He was, as a result of the breach of that price maintenance agreement, ordered to pay a fine instead of having his name put on a stop-list and then, having paid the fine, contended that the demand of the money in these circumstances constituted a felony under s.29(1)(i) of the Larceny Act 1916[69] since it was a demand of money with menaces and "without reasonable or probable cause". The House of Lords, mindful that the gravamen of the charge was the demand "without reasonable or probable cause", unanimously held (in agreement with the decision in the Court of Appeal in *Hardie & Lane* v. *Chilton*[70]) that the demand of such payment, although amounting to a menace, was not "without a reasonable or probable cause" since the Council of the Trade Association was empowered to do so and *bona fide* exercised this power in furtherance or protection of legitimate trade interests and with the *bona fide* intention merely to carry out this trade policy (i.e. the policy of deterring persons in the trade from violating recognised conventions as to maintaining the list prices), not for the mere purpose of putting money in the Association's pocket.[71] The court held the plaintiff to the price maintenance agreement. Such a ruling was a discernible indication of the truth that the court paid no heed to detriments to consumers if the prices were fixed so high as to be unfair to them.

When the judiciary's concerns for fairness in the result of an agreement were overcome by the seemingly extreme notion of freedom of contract, it is not surprising

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[69] S.29 (1)(i) provided: "Every person who utters, knowing the contents thereof, any letter or writing demanding of any person with menaces, and without reasonable or probable cause, any property or valuable thing ... should be guilty of felony, and on conviction thereof liable to penal servitude for life,..."

[70] [1928] 2 K.B. 306.

[71] See [1937] A.C. 797, at 807 per Lord Atkin and at 814 per Lord Roche.

Another reason given by the court was that the payment of the fine as an alternative to the putting of the plaintiff's name on the stop-list was intended to be even more favourable and lenient to the plaintiff: see *ibid.*, per Lord Thankerton at 810, per Lord Russell at 812 and per Lord Wright at 821. This reason is, however, bears no relevance to the issue of freedom of contract and fairness to general consumers now under discussion.

that the existing doctrine that inadequate or even so small consideration was immaterial was congruous with this concept and was continued in its application accordingly. In *Haigh* v. *Brooks*,[72] the defendant had given the plaintiffs a guarantee, in the sum of £10,000, of the repayment of the advance which the plaintiffs had given to a third person for the purchase of cotton. Subsequently, the defendant promised to the plaintiffs that if the plaintiffs would give up to him the guarantee, the defendant would be liable to a certain bills of exchange to be drawn by the plaintiffs. When the plaintiffs had then delivered up to the defendant the written memorandum in which the guarantee was contained, no payment was made by the defendant. In an action of *assumpsit*, the defendant contended that there was no sufficient consideration given for the promise and the giving up of the guarantee could be no more than the giving of nothing in value due to the following facts; viz, (1) that the original guarantee was given after the advance had been made to that third person so that the guarantee was supported only by past consideration and invalid, with the result that the giving up of the guarantee was the giving of nothing in return for the defendant's promise to be liable to the plaintiff upon the bills of exchange, and (2) that the guarantee was not executed in conformity with the formality required by the Statute of Frauds and thus void, which led to the same consequence as in (1). The court felt unable to determine on the issue of past consideration as it was ambiguous from the guarantee instrument (which on its face stated "In consideration of *your being in advance to L.*", not so clearly as where it was by the phrase "*your becoming in advance*" or "*on condition of your being in advance*") whether the advance had been given prior to the guarantee. The Court of Queen's Bench, therefore, decided on the second plea and held that even though the guarantee could be void for non-compliance with the statutory formality, the delivery up of the guarantee could still be a sufficient consideration since it was what the parties judged to be valuable and the court would not look into the disparity of the value of the consideration.[73] This decision was confirmed by the Court of Exchequer Chamber.

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[72] (1839)10 Ad. & E. 309, 113 E.R.119.

[73] The language of Lord Denman C.J., in his delivering the judgment, is of instructive value and worth quoting:

III. THE MID-TWENTIETH CENTURY POSITION

1. General Predicament

Although a few decades in the first half of the twentieth century were dominated by Smithian and Benthamite influences, such economic domination has subsequently become less strong. The twentieth century has witnessed many situations in which an individual who purported to enter into a contract could not look after and maximise his interests due to, for instance, monopolies or lack of understanding of some complexities. Fairness in the outcome of a contract has thus become an important matter of judicial consideration. Although it has been generally believed that the courts in our present century have still made light of this type of fairness and have merely played the role of ensuring fair procedure—ensuring that a contract is free from misrepresentation, duress, undue influence and the like—this conviction can never be without exaggeration. A survey of case law reveals that in reality our twentieth-century courts have, to some extent, attempted to manipulate legal rules in order to render the result of a contract as fair as desirable notwithstanding that the courts, in doing so, have not made an explicit reference to it. Indeed, it is the failure to make such a reference that tends to have considerably spurred the wrong impression that the courts brush aside the question of fairness.

The judiciary's attention to fairness in the result of a contract can be visualised, first of all, from duress cases. As one knows, the court will set aside a contract on the ground of duress only when there have been proved two elements; viz, (1) pressure amounting to a coercion of will of the victim, and (2) illegitimacy of the threat exerted. In order to establish that the pressure amounts to a coercion of will (i.e. the will is "vitiated", "dominated" or "overborne"), the test is generally whether or not the

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"...we *have no concern with the adequacy or inadequacy of the price paid or promised for it.* ... Here, ... the plaintiffs were induced by the defendant's promise to part with something which they might have kept, and the defendant obtained what he desired by means of that promise. *Both being free and able to judge for themselves*, how can the defendant be justified in breaking this promise, by discovering afterwards that the thing in consideration of which he gave it did not possess that value which he supposed to belong to it?": see (1839)10 Ad. & E. 309 at 320, 113 E.R.119 at 123 (italics added).

threatened party has no realistic, practical or effective alternative but his submission to the threat.[74] It is obvious that the first element (i.e the pressure or coercion) is purely the court's primary consideration of procedural fairness, not substantive fairness. But the very second element (i.e. the illegitimacy of the threat) is the judicial creature designed also to strike out unfairness in the end result of an agreement in the following sense. Inarguably, a threat to commit a crime or a tort, which is a *per se* unlawful threat, is illegitimate. But whether or not a threat other than one to commit a crime or a tort (for instance, a threat to breach an existing contract unless the threatened party agrees to a new contract proposed by the threatening party) is legitimate will depend on each particular case and no particular type of threat is regarded as *ipso facto* being illegitimate.[75] Precedent suggests that an illegitimate threat is such a threat as to be offensive to the conscience of the courts.[76] In *Universe Tankerships,*[77] Lord Scarman pointed out that the courts, when determining the legitimacy of the pressure, may have to consider "the nature of the *pressure*" and "the nature of the *demand*" which the pressure is applied to support. The inference which can be drawn from this is that if a demand is for a manifestly exorbitant consideration, then the court is more likely to regard the threat as illegitimate and will consequently avoid the contract on the ground of duress.[78] By the same token, if a demand is for a consideration which is not manifestly exorbitant, the court will be more inclined to discern a threat as a legitimate

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[74] See generally Lord Scarman's expression in *Universe Tankerships Inc. of Monrovia* v. *International Transport Workers' Federation* [1982] 2 All E.R. 67 where he said: "there must be pressure, the practical effect of which is compulsion or the absence of the choice. Compulsion is variously described in the authorities as coercion or the vitiation of consent. The classic case of duress is, however, not the lack of will to submit but the victim's intentional submission arising from the realisation that there is no other practical choice open to him".

[75] G.H. Treitel, *op. cit.*, (footnote 1, *supra*), at 375.

[76] P.A. Chandler, "*Economic Duress: Clarity or Confusion?*" [1989] L.M.C.L.Q 270, at 276.

[77] [1982] 2 All. E.R. 67, at 89.

[78] *Chitty on Contracts* expresses the similar view. It states that a perfectly lawful threat may be illegitimate if coupled with a demand which goes beyond what is normal in commercial arrangement: see *Chitty on Contracts*, 27th edn., (Sweet & Maxwell, 1994), Vol. 1, para 7-012. (In this connection, it should be added that a demand for a manifestly exorbitant consideration will, of course, go beyond the normal commercial arrangement.)

one. It is in this sense that the courts take into account unfairness in the outcome of an agreement, albeit without explicit mention of it.[79]

Judicial cognizance of fairness in an outcome of an agreement without explicitly referring to it can also be found in undue influence cases. It is clear from *Allcard* v. *Skinner*[80] that undue influences can be divided into two categories; viz, (1) actual undue influence and (2) presumed undue influence. In the first category, it must be proved that the agreement has been obtained by certain kinds of improper pressure or by influences *actually* exerted by one party over the other in the sense that the will of one party was dominated by that of the other such that the former acted as the mere puppet of the other. This may happen, for instance, where a promise to pay money is secured by a threat to prosecute a member of the promisor's family.[81] In the second class, undue influence is *presumed* to exist when there is proved a confidential relationship between the parties in the sense that one party has ceded such a degree of trust and confidence in the other as to require that other to show that it has not been betrayed or abused.[82]

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[79] Spencer Nathan Thal, in his article "*The Inequality of Bargaining Power Doctrine: The Problem of Defining Contractual Unfairness*" (1988) 8 O.J.L.S 17 at 20, has reached the same conclusion although he has failed to point out clearly that the courts' endorsement of fairness in duress cases can be in the form of holding a demand for a manifestly exorbitant consideration from the threatened party to be an illegitimate threat which must be set aside on the ground of duress, and *vice versa*.

[80] (1887) 36 Ch.D. 145. See the language of Cotton L.J. at 171.

[81] It is noted that this could perfectly be a case of duress. It should be recalled that before the common law of duress receives a broad application as nowadays, duress at common law was limited to a threat of violence to a person. A threat other than this type was not destructible as a matter of common law. For this reason, the doctrine of undue influence was introduced to give redress to the threatened party. However, as common law of duress has now extended to any case where the will of the party is dominated (or "overborne") by the other, most actual undue influence cases can be dealt with by the application of the common law doctrine of duress. Hence the overlapping between actual undue influence and duress.

[82] The House of Lords, in *Barclays Bank Plc* v. *O'Brien* [1993] 4 All E.R. 417, has further subdivided the second category into two classes: Class 2A and 2B. The former embraces certain relationships which have already been recognised by case law as special or confidential relationships. Examples are a relationship between a solicitor and a client and one between a medical advisor and a patient. Thus, these relationships, *as a matter of law*, raise the presumption of undue influence. The latter describes a relationship which precedent has not yet declared to be one of trust and confidence but the complainant can prove the *de facto* existence of trust and confidence reposed in the other party *vis-à-vis* the transaction concerned. See *infra* for the discussion of this case.

At first sight, it might be perceived that undue influence cases are purely concerned with procedural fairness, not fairness in the terms of a contract. But in view of the current position of English law, this perception is not tenable. English courts have recently developed the undue influence doctrine to such an extent that the courts have added a substantive fairness flavour to it. This has culminated in *National Westminster Bank plc.* v. *Morgan*[83] which was decided by the House of Lords in 1985. All their Lordships deciding this case entirely agreed with Lord Scarman who delivered the judgment to the effect that a transaction could not be set aside on the ground of undue influence unless it was shown that the transaction was to the "manifest disadvantage" of the person subjected to the dominating influence—generally in the sense that the benefit obtained from the dominated person was "*hard and inequitable*", "*immoderate and irrational*" or "*unconscionable*". Lord Scarman overruled the view expressed by the Court of Appeal that where there existed a confidential relationship in the sense as stated above, the transaction was, *as a matter of public policy*, to be set aside on the ground of undue influence even though the transaction provided reasonably equal benefits for both parties.[84] In this regard, Lord Scarman stated[85] that he knew of no reported authority where the transaction set aside

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[83] [1985] 1 All E.R. 821.

[84] See [1983] 3 All E.R. 85 at 90 where Dunn L.J. said: "It is true that in all the reported cases of undue influences the transactions were disadvantageous to the persons influenced, otherwise they would not have sought to set them aside, ... it is *a matter of public policy* which requires that once the relationship of confidence is established, then any possible use of the influence is regarded as an abuse" (italics added). Similarly Slade L.J. expressed: "The purpose of the court in applying the presumption is, *as a matter of policy*, to mitigate the risk of a particular relationship existing between two parties and the influence arising therefrom from being abused. ...Where a transaction has been entered into between two parties who stand in the relevant relationship to one another, it is still possible that the transaction and influence arising therefrom has been abused, even though the transaction is, on the face of it, one which, in commercial terms, provides reasonably equal benefits for both parties", *ibid.*, at 92 (italics added). Both Dunn L.J.'s and Slade L.J.'s views were based on the judgment of Cotton L.J. in *Allcard* v. *Skinner* (1887) 36 Ch.D. 145, at 171: "In the second class of cases, the court interferes, not on the ground that any wrongful act has in fact been committed by the donee, *but on the ground of public policy,* and to prevent the relations which existed between the parties and the influence arising therefrom being abused" (italics added).

[85] [1985] 1 All E.R. 821, at 827.

was not to the *manifest disadvantage* of the person influenced and that the authority showed that the legal character of the transaction had to constitute a disadvantage sufficiently serious to require evidence to rebut the presumption that in the circumstances of the relationship between the parties to that transaction it was procured by the exercise of undue influence.[86]

In speaking of "*manifest disadvantage*", his Lordship alluded to three cases where the courts employed the terms which his Lordship believed could be suggestive of the *manifest disadvantage*" of the person under influence. The first case is *Ormes* v. *Beadel*[87] where Sir John Stuart, the Vice-Chancellor, set aside an agreement which he thought "*hard and inequitable* in itself" and was exacted under circumstances of pressure on the part of the person who exacted it.[88] Lord Scarman next referred to a Privy Council case of *Bank of Montreal* v. *Stuart*[89] where the manifest disadvantage was expressed under the term "*immoderate and irrational*".[90] Finally, Lord Scarman drew attention to *Poosathurai* v. *Kannappa Chettiai*[91] in which Lord Shaw,

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[86] The language of his Lordship apparently suggests that a manifest disadvantage is perceived of as a generator of the presumption of undue influence. This perception was adopted in a later case of *Goldsworthy* v. *Brickell* [1987] 1 All E.R. 853 (C.A.) at 865 per Nourse L.J. (concerning a tenancy agreement between a farmer and a neighbour giving an option to the neighbour to purchase the leased farm on the farmer's death at the 'prevailing value'). An almost identical expression is that although the presumption of 'influence' might have arisen beforehand, without a manifest disadvantage such influence cannot be presumed to be 'undue'; in other words, a special relationship without a manifest disadvantage gives rise merely to the presumption of 'influence', not of 'undue influence': see *ibid.* Notwithstanding, another theoretically possible perception is that the presumption of undue influence has already been perfected and operative but the transaction cannot be set aside if not manifestly disadvantageous to the claimant; and, in this connection, it might be said that the absence of manifest disadvantage is a self-rebuttal of the presumption of undue influence.

[87] (1860) 2 Giff 166, 66 E.R. 70.

[88] *Ibid.*, at 74.

[89] [1911] A.C.120.

[90] *Ibid.*, at 138 where Lord Macnaghten said: "It may well be argued that when there is evidence of overpowering influence and the transaction brought about is *immoderate and irrational*, as it was in the present case, proof of undue influence is complete."

[91] (1919) L.R. 47 Ind. App. 1.

considering undue influence under section 16(3) of the Indian Contract Act 1872,[92] said that the position under this statutory provision was not different from the English doctrine of undue influence in that in order to have a bargain set aside it was to be established not only that the relationship of influences existed but also that, to quote his Lordship's words, "the bargain is ... in itself *unconscionable*". Lord Scarman interpreted the word "*unconscionable*" as indicative of the "manifest disadvantage" to the person influenced. On thorough analysis, all terms employed by the courts in these cases centre on the same thing; namely, the grossly inadequate or grossly unequal consideration. This is, in reality, the judicial mindfulness of substantive unfairness in an agreement although the courts appear to have made no candid reference to it.

However, a word of caution should be here addressed. It is noted that although *Morgan's case* merely concerned a *presumed* undue influence, not an *actual* undue influence, Lord Scarman apparently required the element of "*manifest disadvantage*" in both categories of undue influence. His addition of the "manifest disadvantage" element also to actual undue influence cases can be criticised as being at odds with the rationale of actual undue influence. The rationale of actual undue influence is purely the protection of a party from unfair pressure which dominates and vitiates his will. Therefore, where a pressure exists, a promise given under it should not be enforceable, irrespective of whether or not the benefit obtained by the party exerting the pressure is too small or gross. When A threatened B that he would prosecute B's son if B did not agree to sell B's car at the market price (or even at a higher price than the market price), B should, despite no pecuniary disadvantage in this circumstance, be entitled to avoid the contract simply because it has been obtained not by his free will but as a

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[92] S.16 (3) of the Indian Contract Act provided: "Where a person who is in a position to dominate the will of another enters into a contract with him, and the transaction appears on the face of it, or on the evidence, to be *unconscionable*, the burden of proving that such contract was not induced by undue influence shall be upon the person in the position to dominate the will of the other."

result of a domination by A's threat.[93] By way of comparison with duress cases (given that duress cases, like actual undue influence cases, also concern the vitiation or domination of will), although the courts measure the onerousness of a demand in the process of determining the illegitimacy of the pressure in question, the courts seem to do this mostly in *economic duress* cases. In most cases beyond economic duress cases (specifically speaking, a case of duress to the person or to goods), the threat will be regarded as *per se* unlawful and illegitimate without the court having to measure the manifest disadvantage or the onerousness of the demand. In view of this, the requirement of a "manifest disadvantage" in actual undue influence cases is largely incorrect. Nevertheless, this position, as far as actual undue influence is concerned, has recently been affirmed in *Bank of Credit and Commerce International SA* v. *Aboody*.[94] Fortunately, it has been reversed by the House of Lords in the most recent case of *CIBC Mortgages Plc.* v. *Pitt*.[95] Lord Browne-Wilkinson, with whose judgment the other members of the House agreed, read Lord Scarman's speech in *Morgan's case* as primarily establishing that manifest disadvantage had to be shown in order to raise a presumption of undue influence within Class 2. More importantly, Lord Browne-Wilkinson has expressly stated that actual undue influence is a species of fraud, so that "a person who has been induced by [actual] undue influence to carry out a transaction which he did not freely enter into is entitled to have that transaction set aside *as of right*" (without need of proof of a manifest disadvantage).[96] Of note is that his

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[93] See generally J. Cartwright, *Unequal Bargaining*, (Clarendon Press Oxford, 1991), Chap. 8, pp.174-176.

[94] [1990] Q.B. 923.

[95] [1993] 4 All E.R. 433 (a mortgage of a jointly owned matrimonial home executed, under the pressure by the husband, as security for a loan to the couple in order to, as specified in the agreement, finance the discharge of existing mortgage with the balance to be applied in buying a holiday home, although the husband used the proceeds to buy shares).

[96] *Ibid.*, at 439. However, it was held in this case that the defendant bank was not affected by this undue influence because the husband had not acted as its agent and the bank had no notice, actual or constructive, of the undue influence in question. Additionally, the loan appeared on its face to be a

Lordship also went on to observe that the "manifest disadvantage" requirement announced in *Morgan's case* is in sharp contrast with a separate equitable principle laid down in "abuse of confidence" cases[97] which give relief on the more limited basis of the confidence being abused. In view of this difficulty, his Lordship added that the exact limits of the decision in *Morgan* may have to be considered in the future.[98] Notwithstanding Lord Browne-Wilkinson's remark above, it is submitted that the "manifest disadvantage" element is still good law as long as long as *Morgan* is not yet expressly overruled.

The discussion of the judicial manipulation to achieve a fair result in undue influence cases cannot be completed without a mention of the recent decision by the House of Lords in *Barclays Bank plc* v. *O'Brien*.[99] As with some predating cases, this case concerned an agreement under which one party provided security for debts owed to a creditor by a third party who was closely related to the surety party. The relationship between the surety and the principal debtor in this case was one of husband and wife. The House of Lords, agreeing with the contemporary judgment in the case of *CIBC Mortgages plc* v. *Pitt*,[100] first, emphasised that the sexual and emotional ties between the parties of this relationship generally provided, in relation to financial affairs, the *de facto* existence of trust and confidence and the resulting ready weapon for undue influence.[101] When the transaction in question was to the financial disadvantage to the surety cohabitee, the creditor would undoubtedly be held liable for

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normal advance for the joint benefit of the couple, implying that the bank was not fixed with constructive notice of the undue influence used by the husband, as to which, see *O'Brien*'s case *infra*.

[97] Example, as given by his Lordship, are *Demerara Bauxite Co. Ltd.* v. *Hubbard* [1923] A.C. 673, *Moody* v. *Cox* [1971] 2 Ch. 71.

[98] [1993] 4 All E.R. 433, at 439, 440.

[99] [1993] 4 All E.R. 417.

[100] [1993] 4 All E.R. 433.

[101] [1993] 4 All E.R. 417, at 424.

undue influence exerted by the other cohabitee (the principal debtor) *vis-à-vis* the surety cohabitee if that other cohabitee was acting as the creditor's agent; and in this regard, it was made clear that this agency could even be artificial in the sense that the creditor "left everything" to principal-debtor cohabitee in procuring the other cohabitee to stand as surety for the debts.[102]

The point which centrally portends the court's endeavour to remove the unfair result of the transaction in question (the mortgage of the jointly-owned matrimonial home) lies in the House holding that even in the absence of agency the creditor could be guilty of undue influence if the creditor had notice of the debtor's conduct. The House further explained that this notice need not be actual. Mere *constructive* notice sufficed;[103] and, importantly, when the creditor knew of certain facts which put him on the inquiry as to the possible existence of the abuse of trust by the principal debtor—these facts, in this present case, being that (1) the parties were cohabitees and (2) the transaction was on its face not to the financial advantage to the surety cohabitee—the creditor would be fixed with constructive notice of the undue influence by the principal debtor on the surety. The transaction in question was therefore held unenforceable unless the creditor had taken reasonable steps to satisfy himself that the surety entered into the obligation freely and in knowledge of the true facts.[104] Apparently, constructive notice was introduced into the English law of undue influence even though the creditor in this case committed no procedural wrong under the existing

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[102] *Ibid.*, at 427, applying the principle derived from *Turnbull & Co* v. *Duval* [1902] A.C. 429, Privy Council.

[103] In effect, the rule concerning the constructive notice in this case has not been intended to be confined to undue influence but, as evident from the summary given by Lord Browne-Wilkinson at the end of his judgment, extend to all kinds of 'legal wrong' used by the third party: see [1993] 4 All E.R. 417 (H.L.), at 431. However, our discussion of this issue is limited to undue influence.

[104] [1993] 4 All E.R. 417, at 428, 429. In this case, the wife knew that she was signing a mortgage of the matrimonial home but mistakenly believed that the security was limited to £60,000 and would only last three weeks.

common law and equity; and it is submitted that it was the concern for fairness in the outcome of the contract which exhilarated its introduction.[105]

Manipulative techniques have not only been found in undue influence cases. In reality, the judicial resort to "covert tools" in order to achieve fairness and circumvent undesirable results which would otherwise have arisen from the rigid application of traditional rules of contract law has also been witnessed, in addition to the contexts of interpretation[106] and imposition[107] of contract terms, in the case where the court manipulated the common law doctrine of consideration, as in *Williams* v. *Roffey Bros. & Nicholls (Contractors) Ltd.*[108] There, the sub-contractors received additional sum to cover the low remuneration originally agreed to be paid by the main contractors who were, at the time of the original contract, well aware of the under-price and subsequently offered the extra money out of fear for a penalty which they were to pay under the main contract if the work was not completed within the contract period. In

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[105] In Australia, this account of 'constructive notice' has previously been implanted into case law. It was apparently employed by the court in *The Commercial Bank of Australia Ltd.* v. *Amadio* [1982-1983] 151 C.L.R. 447. The facts of this case have been briefly stated at footnote 231 of Chapter 1, *supra*. It should be recalled that the guarantors/mortgagors were misinformed by their son as regards the limitation of the guarantee. Gibbs C.J., in deciding on the issue as to whether the transaction could be set aside on the ground of misrepresentation, relied on the existing case law, in particular the statement of Lord Cranworth L.C. in *Owen and Gutch* v. *Homan* (1853) 4 H.L.C. 997 at 1034-1035, 10 E.R. 752 at 767, which proclaims that a creditor can be responsible to the guarantor for the misrepresentation made by the original debtor if the dealings are such as fairly to lead a reasonable man to believe that some legal wrong must have been used and thus the circumstances *should have put the creditor on inquiry*. Case law adverted to by Gibbs C.J. clearly stated that in some cases the creditor deliberately abstains from inquiry for fear that he will discover fraud, implying the possibility of both cases of 'wilful ignorance' and cases merely involving an ordinary failure to make inquiry. Surprisingly, Gibbs C.J., however, understood this case law as limited to 'wilful ignorance' cases and, in the present case, did not consider the issue when he felt that it was not clearly raised at the trial: see [1982-1983] 151 C.L.R. 447, at 458, 459.

[106] See, for example, *Andrews Bros. Ltd.* v. *Singer & Co. Ltd.* [1934] 1 K.B 17 (discussed in Chapter 4, *infra*), *Hollier* v. *Rambler Motors (AMC) Ltd.* [1972] 1 All E.R 399 (a clause excluding the defendant garage owner's liability for damage caused by fire to customers' cars on the premises was held to cover only a fire caused without negligence). See also footnote 144 of Chapter 1, *supra*.

[107] See, for example, *Liverpool City Council* v. *Irwin* [1976] 2 All E.R. 39 (H.L.) (term implied into a lease to the effect that the landlord was under the obligation to take reasonable care to keep common parts of the premises in reasonable repair).

[108] [1990] 1 All E.R. 512 (C.A.).

an action by the sub-contractors to claim this additional sum, the court held the promise for this payment enforceable and sufficiently supported by consideration; this consideration was the avoidance of the penalty under the main contract.

2. The Move Towards the "General Principle" of Fairness in Contract

2.1 Overview of the *Lloyds Bank* v. *Bundy* Saga

The late twentieth century has witnessed greater attempts—the judiciary's endeavours to establish the principle which can be generally applicable to exorcise unfairness in the outcome of a contract between the parties. These attempts have culminated in Lord Denning's judgment in the case of *Lloyds Bank* v. *Bundy*.[109] Although this case simply concerned presumed undue influence exerted by the bank over its customer in executing a guarantee and charge, Lord Denning departed from the traditional track in his delivery of judgment. While the other two judges set aside the guarantee and charge on the ground of presumed undue influence—holding that in the circumstances of the case there existed the relationship of trust and confidence between the bank and the defendant and that the presumption of undue influence was not rebutted by showing that the defendant had formed an independent and informed judgment in giving such guarantee and charge despite the company's high prospect of coming to the end of the business—Lord Denning did not base his judgment on this ground (although he treated it as an alternative reasoning if his other reasoning was wrong). His reasoning was, instead, based on a new principle which he proposed: *the principle of "inequality of bargaining power"*. Lord Denning commenced his judgment by proclaiming the general rule: "No bargain will be upset which is the result

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[109] [1974] 3 All E.R. 757.

of the ordinary interplay of forces."[110] After declaring this general rule, he pointed out the exceptions to this general rule as follows:[111]

> "There are exceptions to this general rule. There are cases ... in which the courts will set aside a contract, or a transfer of property, when the parties have not met on equal terms, when the one is so strong in bargaining power and the other so weak that, *as a matter of common fairness*, it is not right that the strong should be allowed to push the weak to the wall."

Lord Denning, dividing these exceptional cases into five categories—(1) duress of goods, (2) unconscionable transactions (expectant heir, poor and ignorant person cases), (3) undue influence, (4) undue pressure and, finally, (5) salvage agreement—induced them into a single underlying principle: the principle of "*inequality of bargaining power*", the essence of which is shown in the following passage:[112]

> "Gathering all together, I would suggest that through all these instances there runs a single thread. They rest on '*inequality of bargaining power*'. By virtue of it, the English law gives relief to one who, without independent advice,[113] enters into a contract *on terms which are very unfair* or transfers property *for a consideration which is grossly inadequate*, when his *bargaining power is grievously impaired* by reason of his own needs or by his own ignorance or infirmity, coupled with *undue influences or pressures* brought to bear on him by or for the benefit of the other."

2.2 Real Significance of *Bundy*: Mere 'Inequality' or 'Unfair Terms'?

The fact that Lord Denning proffered his principle under the name "*inequality of bargaining principle*" may result in the wrong impression that his Lordship was proposing that mere inequality of bargaining power is a sufficient ground for relief. In reality, his Lordship did not contemplate as such. The proposed principle requires three

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[110] *Ibid.*, at 763. In this connection, his Lordship went on to say: "There are hard cases which are caught by this rule. Take the case of a poor man who is homeless. He agrees to pay a high rent to a landlord just to get a roof over his head. The common law will not interfere. Parliament has intervene to prevent moneylenders charging excessive interest. But it has never interfered with banks".

[111] *Ibid.*, at 763 (italics added).

[112] *Ibid.*, at 765 (italics added).

[113] In effect, the mention of "independent advice" in Lord Denning's summarisation of his principle appears to be a mere slip of the tongue. Obviously, independent advice, though relevant in such categories as unconscionable transactions or (presumed) undue influence, is meaningless in the contexts of duress of goods and salvage agreements, for the disadvantaged party is not ignorant of the implications of the terms which he was forced to accept.

elements before a contract can be set aside. First, terms contained in the contract are very unfair or a consideration given to the party transferring property is grossly inadequate. Next, there must have existed such inequality of bargaining power between the parties that the stronger party could push the inferior party to the wall. Finally, it must appear that the superior party, aware of the weakness or infirmity of the other party, actually pushed the latter to the wall without any concern for the distress caused to him. A further analysis leads to the conclusion that Lord Denning intended the courts to apply this principle in the following way. The court should start by determining *whether terms of a contract are unfair or not*. In this stage, although the criteria for determining an unfair character of a term is not clear from Lord Denning's speech, his Lordship seemed to view that the crucial criterion would centre on the grossly inadequate consideration. Indeed, this is evident from his phrase "enters into a contract on terms which are very unfair or transfers property *for a consideration which is grossly inadequate*".[114] When the court is satisfied that the terms in question are unfair under the criterion above, the court should next consider whether, at the time of entering into the contract, there occurred any circumstance in which the party who acceded to such terms had no real choice but submission to them. In this stage, Lord Denning seemed to discern that the party would be taken to be in such a vulnerable situation when and only when his bargaining power was unequal to that of the term-setting party. Then, when the court has found that the terms of the contract are unfair and the complaining party was in the vulnerable situation (in the sense of being of an unequal bargaining power), the court will not set aside the terms unless it is proved that the other party knew of this situation and took advantage of it in fixing the unfair terms.

Based on the analysis above, the fact that Lord Denning's principle suggested the courts to begin the determination by ascertaining unfairness in *the terms* of the contract before moving to determine the party's situation of weakness and the advantage-taking of it is well indicative of Lord Denning's primary concern with substantive fairness in *the terms* of a contract. It follows, therefore, that his principle of

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[114] See the extracted passage at p. 141, *supra*.

"inequality of bargaining power" is, in effect, not primarily the principle of "inequality of bargaining power" but, rather, the principle of, shall we say, "situational unfair terms", whose objective is to strike out unfair terms concluded as a result of an absence of alternatives on the part of one party with the other party fixing such terms upon the knowledge of such a condition. Naming it "the principle of inequality of bargaining power", Lord Denning inadvertently attracted the impression that he was primarily concerned with inequality of bargaining power *per se*. Whatever name his Lordship gave to this principle, it should not be discerned that the principle deals only with procedural unfairness or mere inequality of bargaining power. Rather, this principle should be interpreted as being primarily concerned with fairness in *the terms* of a contract—substantive fairness.[115]

It might be argued that such interpretation is incorrect since Lord Denning's principle requires, in addition to unfairness in the terms of a contract, two other elements; namely, the situation of weakness (i.e. the inequality of bargaining power) of one party and the advantage-taking by the other of that situation in fixing unfair terms. In response to this argument, it can be said that it is undeniable that the other two elements are to be present but the ultimate goal which Lord Denning has apparently attempted to achieve seems to be the obliteration of unfair terms of a contract. This can, indeed, be seen from his enumeration of the five categories of cases from which he has induced into his general principle. All these categories concern the situations where the courts have endeavoured to remove unfair terms in contracts in question. Even though cases in some categories seem to be much concerned with procedural fairness (for instance, duress cases or undue influence cases), Lord Denning, in inducing them

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[115] There has been a massive body of recent literature discussing Lord Denning's principle of inequality of bargaining power. See, for example, L.S. Sealy, "*Undue Influence and Inequality of Bargaining*" [1975] C.L.J 21; Christopher Carr, "*Inequality of Bargaining Power*" (1975) 35 M.L.R 463; Slayton, "*The Unequal Bargain Doctrine: Lord Denning in Lloyds Bank v. Bundy*" (1976) 22 McGill L.J. 95; and Spencer Nathan Thal, "*The Inequality of Bargaining Power Doctrine: The Problem of Defining Contractual Unfairness*", *op. cit.*, (footnote 79, *supra*). None of these works has stated that Lord Denning's principle is primarily concerned with substantive fairness in contract. In this regard, Cartwright, in his "*Unequal Bargaining*", *op. cit.*, (footnote 93, *supra*), p. 218, has stated that Lord Denning did not intend mere inequality of bargaining power to give rise to a remedy and that the inequality of position was to be linked with the unfairness of the bargain. However, like other authors, he has failed to point out that, in proposing the principle of inequality of bargaining power, Lord Denning's primary concern was with fairness in the terms of a contract.

into his general principle, appears to be more concerned with the substantive fairness dimension.

It is noted that Lord Denning's first category is devoted to accommodating duress cases. Inarguably, duress cases may be concerned purely with procedural fairness, as in the case where one party puts a gun at the other party's head in order to induce that other party to agree to sell his car to the former at a very fair price, even a price much higher than its market price. However, Lord Denning does not appear to be concerned with this kind of purely procedural unfairness situation. In this category, he only spoke of "duress of goods", where the party being in possession of the goods of the other who is in urgent need of them demands of that other party (the weaker) more than is justly due.[116] This is elucidative of his primary concern with fairness in *the terms* of the contract rather than procedural fairness. Similarly, in his third category, he placed undue influence cases and stated that there are two classes of undue influence cases, namely, the *actual* undue influence where the stronger party obtains a contract by his wrongful act and the *presumed* undue influence where the party who is in a confidential relationship gains some gift or unfair advantage from the other party who reposes such confidence in the former. The first class purely concerns procedural unfairness[117] whereas the second deals more with fairness in the result of the contract since the courts will let the contract stand only when it is proved that the gift or the advantage received by the party in such a confidential relationship is fair (unless the other party has formed his independent judgment in making the gift or giving the unfair advantage). It is clear from Lord Denning's discussion of undue influence cases that it is only from the second class of cases that his induction into a general principle was made.[118] Here again, this throws much light on Lord Denning's primary concern with fairness in the terms of this type of contract.

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[116] See [1974] 3 All E.R. 757, at 763.

[117] It should be noted that at the time of the decision in *Bundy's* case, the requirement of "manifest disadvantage" was not yet openly introduced into the doctrine of undue influence. As previously explained, such requirement was proposed by Lord Scarman in *Morgan's case*, which postdated *Bundy's case*.

[118] See [1974] 3 All E.R. 757, at 764.

A few closely related facts are worth observing. With regard to "unconscionable transactions" (dealing with poor and ignorant persons) which fall under Lord Denning's second category, it has been asserted in recent studies by modern writers that the courts' invalidation of these transactions is, in large part, the judicial unarticulated concern with the primacy of substantive fairness.[119] This assertion obviously lends support to the conclusion in this thesis that Lord Denning's principle primarily concentrates on fairness in the terms of a contract. In addition, Atiyah also asserts that equitable doctrines are clearly concerned with the substantive fairness of transactions.[120] Most interestingly, Atiyah further contends that ideas of substantive fair exchange appear to be increasing in importance today and that there are many trends, both in case-law and in statute law, to give protection to parties who enter into contracts not wholly appreciating or understanding the full implications. In this connection, he cites *Bundy*'s *case* as a striking illustration of these trends and spells out that this case looks like a case of procedural unfairness but it is so clear, especially from Lord Denning's judgment, that substantive unfairness played an important part in the decision.[121] Apparently, this comes close to the conviction that Lord Denning's principle focuses on substantive unfairness.[122]

2.3 Rejection of Lord Denning's General Principle

Lord Denning's general principle of the "inequality of bargaining power" has not survived and has been repudiated mainly in two subsequent cases: *Pao On* v. *Lau Yiu Long*[123] and *National Wesminster Bank* v. *Morgan*[124]; the latter was decided by

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[119] See Mindy Chen-Wishart, *op. cit.*, (footnote 28, *supra*), pp. 104-116; Robert Clark, *op. cit.*, (footnote 28, *supra*).

[120] Atiyah, "*Contract and Fair Exchange*" in *Essays on Contracts*, (Clarendon Press Oxford, 1988), Essay 11, p. 329, at 331.

[121] *Ibid.*, at 343.

[122] Indeed, A.D.M. Forte, in "*Unfair Contract Terms: Evaluating an EEC Perspective*" [1985] L.M.C.L.Q. 482 at 486-487, seems to share the same view. Addressing first that the courts are no longer prepared to wait for legislative reform to combat unfairness, he contends that Lord Denning's advocacy of the principle of inequality of bargaining power is an attempt to formulate an "overtly justice-based principle".

[123] [1980] A.C. 614 (Privy Council).

the House of Lords. It is not wholly clear whether the reason for rejecting this principle is because the courts interpreted the principle as proposing that mere inequality of bargaining power could give rise to a remedy and then disagreed with this *or* because the courts were well aware that the principle was primarily and principally concerned with the evisceration of unfair terms, not mere inequality of bargaining power between the parties, but thought that the principle was not appropriate nonetheless. It is submitted that it is unimaginable that the courts could view Lord Denning's principle as proposing mere inequality of bargaining power *per se* as a sufficient ground for setting aside a contract or any terms contained therein. At least, the element that contract terms must be very unfair can hardly elude the courts' observation. In addition, the courts must have noticed that in *Bundy*'s *case* if the terms of a contract had not been unfair, the weaker party would not have brought the case to the court merely because that weaker party was, without more, discontent with the inequality of bargaining power. These being so, the reason for the courts' rejection of Lord Denning's principle hardly lies in any perception that Lord Denning erroneously proposed inequality of bargaining power *per se* as a ground of relief.

The real foundations upon which the rejection of Lord Denning's principle of inequality of bargaining power rests can be discovered mainly from Lord Scarman's judgment in *Morgan's case* itself, the judgment which has been concurred in by all other members deciding that case. First, as the contract in *Morgan's case* was, on the facts, concluded under presumed undue influence, the House of Lords thought that the case could be decided perfectly by the application of the traditional doctrine of undue influence without need of resorting to such a general principle as Lord Denning suggested.[125] However, this is obviously not the reason for generally rejecting the application of Lord Denning's principle in *all kinds of cases* but can be, at most, the reason for its rejection merely in undue influence cases. The genuine reason for its rejection owes something to do with the court's fear that in employing the general

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[124] [1985] 1 All E.R. 821 (H.L.).

[125] In this connection, Lord Scarman said, at 830: "The doctrine of undue influence has been sufficiently developed not to need the support of a principle which by its formulation in the language of the law of contract is not appropriate to cover transactions of gift where there is no bargain".

principle, the judiciary would be regarded as interfering with the legislative function of Parliament. Lord Scarman clearly reiterated that Parliament had so far interfered with unfair contracts in many instances and then if the court employed this general principle to strike down unfair terms obtained by means of inequality of bargaining power, the court would be enacting further restrictions on freedom of contract in addition to the existing restrictions enacted by Parliament. The task of eviscerating unfair terms of a contract must, in Lord Scarman's view, be left to Parliament. This is reflected in the following passage from his judgment:[126]

> "And even in the field of contract I question whether there is any need in the modern law to erect a general principle of relief against inequality of bargaining. Parliament has undertaken the task (and it is essentially a legislative task) of enacting such restrictions on freedom of contract as are in its judgment necessary to relieve against the mischief: for example, the hire-purchase and consumer protection legislation, of which the Supply of Goods (Implied Terms) Act 1973, the Consumer Credit Act 1974, the Consumer Safety Act 1978, the Supply of Goods and Services Act 1982 and the Insurance Companies Act 1982 are examples. I doubt whether the courts should assume the burden of formulating further restrictions."

As manifest from this passage, the House of Lords, in rejecting the application of the general principle of inequality of bargaining power to invalidate unfair terms in a contract, did not proffer that fairness in the terms of a contract was immaterial and unimportant itself. The House merely thought that the task of alleviating substantive unfairness should be left to Parliament to perform by means of legislation. After all, the fact that the House of Lords was under the impression that Parliament should take its legislative function to enact legislation for removing unfair terms as Parliament thinks fit is indicative of the House's recognition of fairness in contractual terms. It would, therefore, be wrong to equate the court's rejection of Lord Denning's general principle with the judicial manifestation of rejection of fairness in the terms of a contract.[127]

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[126] *Ibid.*, at 830.

[127] In this regard, Spencer Nathan Thal, in *op. cit.* (footnote 79, *supra*) at 19-20, has expressed a somewhat similar view. He said: "However the fact that the courts have rejected the doctrine [of inequality of bargaining power] does not answer the question of whether or not the courts have regard to considerations of fairness when asserting contractual validity ... then it seems as if the rejection of the inequality of bargaining power doctrine is no more than a smokescreen to conceal the fact that courts often consider fairness relevant to validity, and will make decisions on that basis. Notwithstanding, his perception is not identical to one presented in this thesis. In his expression

Another reason for the subsequent courts' rejection of Lord Denning's principle could be the courts' fear for uncertainty which would supposedly arise from the determination of what amounts to fair or unfair terms for the purpose of applying the principle (given that, as previously discussed, ascertaining unfair terms is one step of applying Lord Denning's general principle[128]). This can, perhaps, be reflected from the judgment delivered again by Lord Scarman in *Pao On*'s *case*.[129] Although this case did not directly concern the general principle as laid down by Lord Denning—it was decided merely on the question of consideration and economic duress—part of the judgment implies the judge's attitudes towards the determination of "unfairness", including unfairness in the terms of a contract. Briefly speaking about what happened in that case, Lord Scarman, thinking that performance (or promise of performance) of a contractual duty owed to a third person could be a sufficient consideration, found on the facts that the promise the plaintiff sought to enforce in the case before him was supported by this type of consideration. It was, then, contended by the defendant promisor that despite such a consideration which would otherwise have made the promise enforceable the consideration in this case was, as a matter of public policy, invalidated by an *unfair use* of dominating bargaining position. Lord Scarman took the view that to hold that an unfair use of a dominating bargaining position invalidated the consideration would, to quote his Lordship's words, "render the law uncertain" since "*it would become a question of fact and degree to determine in each case whether there had been an unfair use of a bargaining position*".[130]

It might, at first sight, be argued that this *ratio decidendi* has to do not with the court's fear for uncertainty arising from the determination of unfairness in *the terms of a contract* but, rather, with unfairness in *the use of a strong bargaining position*. To

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above, Thal merely meant that the courts, despite their rejection of Lord Denning's general principle of inequality of bargaining power, have continued to make evaluations of fairness in the course of applying the well-recognised doctrines of duress and undue influence (in the similar sense to what we have previously discussed). Thal has not argued that Lord Denning's principle is primarily concerned with substantive fairness.

[128] See p. 141, *supra*.

[129] [1980] A.C. 614 (Privy Council).

[130] *ibid.*, at 634.

remonstrate this argument, it is undeniable that the court before which *Pao On* was decided was dealing with the difficulty in ascertaining or determining an *unfair use* of a dominating bargaining position; but the difficulty felt by the judge rested upon the word "*unfair*", not the "*use*" of such a dominating bargaining position. This being so, the court's trepidation about uncertainty susceptible of stemming from the ascertainment of "*unfair use*" can equally apply to the determination of "*unfair terms*" as well—that is to say, in the court's view, it would be a question of fact and degree to determine in each case whether the terms of the contract in question are fair or unfair. Supposedly, it is this type of trepidation that also prompted the judges', in *Morgan's* case, feeling that the task of determining unfair terms of contracts should be left to Parliament. Again, it should be stressed that the rejection of Lord Denning's general principle has too little to do with the rejection of fairness in the terms of a contract. From the mid-twentieth century, the increasing magnitude of judicial concerns for this type of fairness has not ceased to be witnessed; in fact, it tends to be so to the betrayal of the lip service the courts have paid to the notion of non-intervention.

3. Fairness in the Terms of Contracts Concluded without Advantage-Taking

It must be pointed out in the penultimate section of this chapter that although the courts have increasingly taken into account fairness in the terms of a contract, such regard remains confined to unfair terms which have been agreed upon as a result of the *advantage-taking* by one party of the other's situation representing an absence of choice. Without such an element of advantage-taking, the courts will disregard a harsh consequence of a private deal. The holding of this position can be visualised, first, from Lord Denning's proclamation in *Lloyds Bank* v. *Bundy* itself. It should be recalled that Lord Denning, before enumerating the five categories of cases (in which the courts have intervened in unfairness of a contract) and subsuming them under a single principle of inequality of bargaining power, stated the general rule that "no bargain will be upset which is a result of the ordinary interplay of forces". As illustrations of this rule, he referred to a case of a poor homeless man agreeing to pay a high rent to a landlord just to get a roof over his head as well as a case of a person in urgent need of

finance borrowing money from the bank at high interest and said that common law would not assist these parties.[131] It is obvious that his Lordship, in providing these illustrations, contemplated the setting where there is no direct advantage-taking of the situation of the weak party (i.e. where the fixing of such a high rent or interest is not inspired by the prompt knowledge of the necessitous situations of the tenant or the borrower). This interpretation is buttressed by the fact that the setting in which the landlord or the lender directly takes advantage of a circumstance of infirmity of the other party would be analogous to a case of the salvage agreements category—Lord Denning's fifth category—in respect of which his principle of inequality of bargaining power would eviscerate the resultant unfairness in relevant terms.

More obviously, the position that the courts do not meddle with unfairness in the terms of a contract in the absence of an advantage-taking by one party of the other party's circumstance of weakness has been affirmed in Lord Brightman's expression addressed in the recent Privy Council case of *Hart* v. *O'Connor*:[132]

> "If a contract is stigmatised as "unfair", it may be unfair in one of two ways. It may be unfair by reason of the unfair manner in which it was brought into existence; a contract induced by undue influence is unfair in this sense. It will be convenient to call this "procedural unfairness". It may also, in some contexts, be described (accurately or inaccurately) as "unfair" by reason of the fact that the terms of the contract are more favourable to one party than to the other. In order to distinguish this "unfairness" from procedural unfairness, it will be convenient to call it "contractual imbalance". The two concepts may overlap. Contractual imbalance may be so extreme as to raise a presumption of procedural unfairness, such as undue influence or some other form of victimisation. *Equity will relieve a party from a contract which he has been induced to make as a result of victimisation. Equity will not relieve a party from a contract on the ground only that there is a contractual imbalance not amounting to unconscionable dealing.*"

In this passage, the element of advantage-taking is undoubtedly reflected in the language "victimisation". It has been made clear that absent this a contract will not be invalidated. It is, however, noted that Lord Brightman, unlike Lord Denning, seemed

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[131] [1974] 3 All E.R. 757, at 763.

[132] [1985] A.C. 1000, at 1017 (italics added).

to concentrate on procedural unfairness rather than substantive unfairness and view the latter merely as evidence or presumption of the former.[133]

As Chapter 1 has demonstrated, it is inept to neglect, in the present era of modern market conditions, fairness in the terms of a contract which has been acceded to even in a setting involving no direct advantage-taking. Accession to harsh terms in a written contract as a result of the unavailability of reasonable time to ascertain them or on account of inability to understand them may not necessarily be conceived of as involving an advantage-taking or victimisation. It is on this basis that the position as affirmed in *Hart* v. *O'Connor* above cannot be regarded as sufficient in protecting contracting parties. A new general rule still needs to be introduced.

IV. CONCLUSION

In early centuries before the emergence of the Laissez-Faire ideology, substantive principles governing contracts, which were then in the form of *assumpsit*, were generally absent. The courts' reaction in regard to individual agreements was merely to allow people to enforce a promise by following an appropriate "form of action" laid down by the courts. However, the courts required consideration in a contract not under seal and tended to generally disregard fairness in the outcome of a contract by holding that even grossly inadequate or too small consideration was immaterial if no fraud or unconscientious means was shown to have been exercised. It was only in the exceptional context of restraint of trade that the courts appeared to uphold this type of fairness through their apparent insistence upon adequate consideration. Also, it was only in some exceptional cases that the courts were seen indirectly intervening in unfairness caused without fraud. However, a type of business cooperation which may ultimately have resulted in unfair prices to consumers at large were generally prohibited.

In the mid-nineteenth century, the courts were heavily influenced by Smithian and Benthamite economic concepts in candidly taking the position that each could look

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[133] This is, in effect, the same view as one expressly stressed in the early case of *Griffith* v. *Spratley*, as to which see p. 115, *supra*.

after his own interests. The courts thus tended to increase their disregard of unfairness in the terms of a contract. The doctrine that inadequate consideration was immaterial was continued to be applied. Moreover, business activities which could bring about unfair prices to consumers at large even generally received the judicial sanction.

After the mid-twentieth century, Smithian and Benthamite influences have dwindled and the courts have attempted to promote fairness in the outcome of an agreement by, in addition to the techniques of interpretation and imposition of contract terms, manipulating traditional rules of contract law without explicit reference to it, particularly in their considerations of duress and undue influence cases. An effort has been made to propose the general principle of "*inequality of bargaining power*" to strike out unfair terms in a contract concluded as a result of an advantage-taking by one party of the other's situational infirmity. Although this principle has subsequently been rejected by the courts, its rejection is not necessarily an augury of the judiciary's perception that fairness in the terms of a contract is unimportant. The courts have merely felt that the task of determining what terms are unfair and deserve evisceration should be left to Parliament. However, given the problem of informational asymmetry which has been discussed in Chapter 1, judicial attempts in our present century remain insufficient as long as it is taken that fairness in the terms of a contract which is reached without the element of advantage-taking is to be generally disregarded. Parliament should also take a hand to redress losses sustained by contracting parties as a result of such ignorance as generated by the lack of opportunity to ascertain contractual terms or by the complexity of draftsmanship. In the next Chapter, we will look at the measures the legislature has particularly taken in enacting the Unfair Contract Terms Act 1977.

CHAPTER 3

THE UNFAIR CONTRACT TERMS ACT 1977

I: INTRODUCTION

The thesis has so far proposed the "general rule" to police unfair terms in contracts. The emergence of the Unfair Contract Terms Act 1977 (hereinafter called "UCTA") may, at first sight, create an image that supervisory measures *vis-à-vis* the protection of contracting parties against unjust clauses have already culminated in this legislation. This Chapter is, therefore, aimed at demonstrating that the enactment of UCTA is a spurious proxy for the sufficient protection. The skeleton of this legislation will be outlined, with criticisms and commentary on the Act's framework, in an endeavour to suggest the correct account of safeguarding contracting parties. Cases decided under UCTA will also be looked at.

II: OUTLINE OF UCTA: A GENERAL RULE OF UNFAIR CONTRACT TERMS?

1. Overview

This Act's title deludes its real character. UCTA deals only with exclusion clauses, which form merely one instance of "possibly unjust"[1] contractual terms, rather than with contractual terms in general. Considered in the light of a "general rule", UCTA can be said as, at most, introducing a general rule for the control of *exclusion clauses*, not a general rule for the control of *contractual terms in general*. In other words, the general rule under the Act, though exhibiting a somewhat prophylactic nature, has been launched on a *piece-meal* basis. Therefore, the generality of such a rule is, shall one say, merely "limited generality", not "full-scale generality".

Given that this thesis intends to investigate UCTA with a view to obtaining from its empirical experience some thoughts on the appropriate or inappropriate

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[1] It is "possibly" unjust because an exclusion clause cannot be regarded as unfair in and by itself. Based on the analytical framework in Chapter 1, without procedural deficiency, such a clause can be no more than substantive unfairness *per se*.

approach of scrutinising contractual terms, the "limited generality" of UCTA does not render itself devoid of research value as far as the general rule for the control of unfair terms in contract is concerned. It still warrants a critical study simply because this "limited generality"—the general rule for controlling exclusion clauses—is capable of casting light on how the "full-scale generality"—the general rule for controlling contractual terms in general—should be introduced.

As far as the exclusion clause instance is concerned, a number of UCTA's provisions govern not general clauses of exclusionary nature but more specific exemption clauses. These include clauses, contained in a written guarantee, excluding or restricting liability for the loss or damage which arises from "consumer goods" (defined as goods of a type ordinarily supplied for private use or consumption) proving defective while in consumer use due to the negligence of the manufacturer or distributor (Section 5); clauses excluding or restricting the implied conditions imposed by the Sale of Goods Act 1979 and the Supply of Goods (Implied Terms) Act 1973 (which deals with hire-purchases) regarding title (Section 6 (1)), conformity of goods with descriptions or samples, and quality or fitness for a particular purpose (Section 6 (2)); similar clauses in contracts which, though not governed by the law of sale of goods or hire-purchase, involve the passing of the possession or ownership of the goods (Section 7);[2] and clauses excluding or restricting liability for misrepresentation (Section 8, which is substituted in Section 3 of the Misrepresentation Act 1967).[3]

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[2] Examples of these contracts, insofar as they are known to English law, are contracts of hire, contracts of exchange and contracts for work and materials. Due to the similarity of these types of contracts, in the light of the passing of ownership or possession, to one of sale or hire-purchase, it is felt by the courts and the Law Commission (see Law. Com. No. 69, paras 12-28) that such statutorily implied terms (as to title, conformity, quality and fitness for a particular purpose) as applicable to contracts of sale or hire-purchase should, by analogy, apply to these contracts as well: see, for example, *Young & Marten* v. *McManus Childs* [1969] 1 A.C. 454 at 466-467. It is on this basis that Section 7 of UCTA subjects exclusion clauses involving the corresponding implied terms in these contracts to the same rules governing contracts of sale and hire-purchase.

[3] It is noted that although UCTA can be generally said as dealing with "exclusion clauses", one section of it—section 4—must be treated as an exception as long as it governs not exclusion clauses as such but "indemnity clauses". This is the type of clause whereby one party requires another party to indemnify the former or a third party against liability which is incurred by that former party or such third party, whether directly or vicariously, to that other party or to someone else. This section prohibits the use of this clause against a consumer unless the clause satisfies the requirement of reasonableness under the Act. However, although an indemnity clause cannot be squared with an exclusion clause in a strictly literal sense, its practical consequence comes close to that produced by an

UCTA employs two approaches of control of exclusion clauses—either absolute prohibition (by declaring the clause concerned absolutely invalid) or subjection of the clause to a test of "reasonableness" set forth under the Act. Certain types of these specific exclusion clauses are based upon the absolute ban approach. This is the case in respect of the following clauses: disclaimers in guarantees under Section 5 above; disclaimers relating to the implied conditions as to conformity of the goods with description or sample or as to quality or fitness for a particular purpose where they are invoked by the party who makes the contract in the course of a business against the party who does not make the contract as such (Sections 6(2) and 7(2)); disclaimers relating to the implied undertaking as to title of the goods, whether they are invoked against the consumer party or non-consumer party (Sections 6(1) and 7(4)). The remainder of these specific instances rest upon the "reasonableness" test approach.

It should be remembered that this thesis seeks to explore the "general rule" for the control of unfairness in general contract terms. Therefore, the investigation of UCTA *vis-à-vis* those provisions which deal with highly "specific" exclusion clauses is not the main concern of the thesis. In particular, the provisions which rest upon the absolute prohibition approach will apparently fall outside its scope of analysis, simply because this thesis's framework is, as has already been explained in Chapter 1, not based upon the outright prohibition of contract terms or imposition of compulsory terms in individual agreements. Thus, the provisions of UCTA which are central to the thesis's examination of the "general rule" are those sections which exhibit the character

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exclusion clause in the sense that the guilty party can generally be absolved from loss as long as he can be indemnified by the innocent party against damages he (the guilty party) has paid for his breach or negligence. It will be shown below that case law established in *Phillips Products Ltd.* v. *Hyland* [1987] 1 W.L.R. 659 requires that a clause which has an ultimate effect of transferring liability from A to B will necessarily be categorised as an exclusion clause. Given this rule, it is arguable that a separate treatment of indemnity clauses under section 4 is rendered redundant. Moreover, such a separate treatment is problematic due to the divergence of approaches employed in the Act. An indemnity clause may arise which purports to indemnify a party against liability for death or personal injury resulting from negligence. As section 2(1) absolutely prohibits the exclusion or restriction of this liability, an anomaly will follow that such a clause can, at the conceptual level, possibly be shown to satisfy the reasonableness test under section 4 but is to be declared void if expressly framed as an exclusion clause under section 2. See also David Yates, *Exclusion Clauses in Contracts*, 2nd edn., (1982, Sweet & Maxwell), Chap. 3, p. 87; R.G. Lawson, "*Contract Terms: Interpretation, Liability and Reasonableness*", (1988) 132 Solicitor Journal 146; Elizabeth Macdonald, "*Mapping the Unfair Contract Terms Act 1977 and The Directive on Unfair Terms in Consumer Contracts*", [1994] J.B.L. 441 at 447-450.

of "generality". Such provisions can be found in Sections 2 and 3 which stand as the key sections of the entire Act. The remainder of this Chapter will, then, proceed on the basis of both of these sections, with other sections being yet considered or alluded to only insofar as it is necessary for the purpose of comparison.

2. Significance of Sections 2 and 3

Sections 2 and 3 are the fundamental part of the Act in the light of clauses of exclusion. Both sections apply only to "business liability" which is defined as liability for breach of obligations or duties arising from things done or to be done by a person in the course of a business or from the occupation of premises used for business purposes of the occupier.[4] UCTA draftsmen seem to realise that liability commonly sought to be excluded can be both liability in negligence and liability in contract. Based on this, section 2 is, when spoken in the context of *contractual terms*,[5] intended to deal with clauses which exclude or restrict liability for negligent acts. The distinction is made between liability for death or personal injury and liability for other types of loss or damage caused by negligence. By section 2(1), liability for death or personal injury cannot be disclaimed—a resort to the absolute ban approach. It is, under section 2(2), only liability for other loss or damage that may be excluded or restricted provided that such an exclusion or restriction is reasonable when determined in accordance with the "reasonableness test" provided by the Act.[6]

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[4] S. 1(3).

[5] The phrase "in the context of contractual terms" must be added because of the fact that apart from its application to exclusion clauses contained in a contract, section 2 also applies to a "notice" which does not have contractual effect. The assimilation of contract terms and notices in this section is intended to dispose of difficulty in distinguishing between contracts and conditional licences such as arose in *Gore* v. *Van der Lann* [1967] 2 Q.B. 31. However, given that this thesis is merely concerned with the control of unfair terms in *contracts*, UCTA's applicability to "notices" will not be discussed here.

[6] The Law Commission, in preferring the "reasonableness requirement" approach, concludes that an "absolute ban" is undesirable since it would not operate to the advantage of consumers in the situation where they are given a choice between accepting the risk of loss upon paying a lower price and leaving the risk to the firm upon paying a higher rate. A complete ban would deprive consumers of the former choice: see Law. Com. No. 69, para 57-58. The same view is adopted in relation to exclusion of contractual liability: see the following discussions in the text, *infra*; and see Law. Com. No. 69, para 158.

The real crux of UCTA lies in section 3 which deals with contractual liability. This section polices unfairness in exclusion clauses, contained in contracts, not by prohibiting their insertion or incorporation into an agreement but by requiring them to pass the reasonableness test. Exclusion clauses which fall within the operation of this section are (1) clauses which purport to exclude or restrict liability of a party when he himself is in breach of contract;[7] (2) those which allow a party to render a contractual performance substantially different from that which is reasonably expected of him;[8] and, finally, (3) clauses which permit a party to render, in respect of the whole or any part of contractual obligation, no performance at all.[9]

3. Exclusion Clauses Caught by Section 3 Revisited

3.1 Comprehensiveness of the Protection

Viewed in the context of exclusion clauses, section 3, in a way, stands as a comprehensive provision. Firstly, the three types of exclusion clauses embraced by this section are those clauses the insertion of which is not unusual. It is obvious that such a clause which purports to entitle a party to render no performance at all is illusory unless some reasonable ground for non-performance is specified. In the absence of reasonable basis for the abstention from performance, the illusion lies in the fact that the clause is no more than a pure declaration of intent, thereby giving the favourable party the right to perform or not to perform the obligation as he pleases.[10] The incidence where a party seeks to exclude or limit liability for his breach of contract can be more often visualised.

Next, the legislature seemed to be astute of the fact that if the Act was merely to police the exclusion or restriction of "liability", the term-setting party could

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[7] S. 3(2)(a).

[8] S. 3(2)(b)(i).

[9] S. 3(2)(b)(ii).

[10] As for a clause allowing substantially different performance from the reasonable expectation, see text accompanying footnote 14, *infra*.

circumvent the supervisory teeth of the Act through the application of such a contract clause which does not exclude or restrict "liability" in the first place but, instead, restricts "right" or "remedy" of the other party or causes that other party difficulty in enforcing his right against the former in respect of that liability. UCTA forestalls this ingenious device by, under its section 13(1), declaring that the phrase "exclude or restrict liability" shall include making the liability subject to restrictive or onerous conditions;[11] excluding or restricting right or remedy;[12] subjecting another party to prejudice if such party enforces contractual right or remedy;[13] excluding or restricting rules of evidence or procedure.[14]

Further, the framers also envisaged that a focus on the "exclusion" or "restriction" of liability in the strictly literal sense may have resulted in the industry disguising or concealing the exclusionary nature of the intended clause by expressing or couching it in a style which carries no explicit appearance of a disclaimer of liability notwithstanding that the substance of the clause leads to such an exculpatory effect. This type of clause is known as a "definitional clause". The industry resorts to the language which "defines" or "modifies" obligation. For instance, a clause may provide that the performance in a specified manner shall be regarded as full performance and not be treated as a breach of contract. In most cases, laypersons are likely to understand that such a clause is free from any drastic effect although in reality its

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[11] E.g. a clause which requires another party to give notice of loss or bring an action with regard to such loss within an unreasonably short period of time or to follow some unreasonably difficult procedure in lodging a claim.

[12] E.g. a term by which one party, though not excluding or restricting liability *ab initio*, deprives the other of a right to rescind the contract in the event of breach of condition by the former, or a term which excludes the buyer's right to withhold payment of any amount due to the seller by reason of set-off, as in *Stewart Gill Ltd.* v. *Horatio Myer & Co. Ltd.* [1992] 2 All E.R. 257 (discussed in part III, *infra*) where Lord Donaldson M.R., *ibid.* at 260, uttered a colourful expression: "It is a trite fact...that there are more ways than one of killing a cat".

[13] E.g. a clause which provides that if the buyer-dealer enforces his right under the sale agreement, the manufacturer-seller will discontinue supply.

[14] See also Elizabeth Macdonald, "*Exclusion Clauses: the Ambit of S.13(1) of the UCTA 1977*", (1992) 12 Legal Studies 277 and her recent article "*Mapping The Unfair Contract Terms Act 1977 and The Directive on Unfair Terms in Consumer Contracts*", [1994] J.B.L. 441, at 443 for relevant discussion.

implication runs counter to their expectation, in the sense that if the contract is performed in that specified fashion the performance can be substantially different from what they intend to achieve from the contract. An illustration can be furnished by a clause in a contract to provide security (whereby a security firm agrees to provide security services, by the night patrol, for a factory) which stipulates that the security firm can perform the contractual obligation simply and merely by exercising due diligence in *employing* natural persons of reliable antecedents to conduct the night patrol for the safety of the factory. At first glimpse, this clause does not exclude or restrict liability but, in reality, has the effect of relieving the security firm from liability for any loss caused by careless patrol of their employees since the clause requires that the security firm perform obligation merely by exercising due diligence in the process of selecting these persons, without also requiring that any loss to the factory caused by any act of these persons shall be under the security firm's responsibility. Apparently, this is contrary to the reasonable expectation of the factory owner.[15] By virtue of

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[15] This example is derived, with modification, from *Photo Production Ltd.* v. *Securicor Transport Ltd.* [1980] A.C. 827 (H.L.). In *Photo Production*, the clause in question provided, *inter alia*, that the company shall, under no circumstances, be responsible for any injurious act or default by its employee unless it could have been foreseen or avoided by the exercise of due diligence by the company as employer. All members of the House of Lords concluded that Securicor committed a fundamental breach (as to which, see the discussion accompanying footnote 20, *infra*) when its employee lit a fire which then destroyed the factory, for it was an implied obligation of the security company to "operate the service with due and proper regard to the safety and security of the premises" (per Lord Wilberforce at 846). Then, it was held that the exclusion clause, as a matter of construction, expressly relieved the security company from liability. However, Lord Diplock's view appeared distinct. Although he agreed with the approach taken by Lord Wilberforce above, his Lordship seemed to present an alternative ground of decision: that Securicor did not breach its obligation in the first place. Lord Diplock, at 851, envisaged a dichotomy of obligations: "primary" obligation and "secondary" obligation (the latter being one to pay monetary compensation for the breach of the former) and said that in the instant case the primary obligation was *modified* by the clause to the effect of not being absolute but limited to exercising due diligence in its capacity as employer to procure that the patrolman should exercise reasonable skill and care for the safety of the factory. Apparently, this ground of decision is reflective of the deployment of "definition" or "modification" draftsmanship.

For the sake of comparison, see also the courts' conflicting attitudes, in the context of liability for misrepresentation, towards the use of "sham" language to conceal the true nature of the otherwise exclusion clauses in the following cases: *Overbrook Estate Ltd.* v. *Glencombe Properties Ltd.* [1974] 1 W.L.R. 1335 (clause limiting the authority of the agent to make representations was held not exclusion clause); *Cremdean Properties Ltd.* v. *Nash* (1977) 244 E.G. 547 (clause specifying that statements given by agents were merely for the convenience of an intending purchaser or tenant of property and that any purchaser or tenant was to satisfy the correctness of such statements by himself was thought by the Court of Appeal, at 551, as the "ingenuity in the form of language to defeat the plain purpose at which section 3 (of the Misrepresentation Act) is aimed", which, to Bridge L.J. who agreed with Fox J. in the court below (1977) 241 E.G. 837, the courts would not be ready to allow); *Collins* v. *Howell-Jones* (1980) 259 E.G. 331 (clauses similar to one in *Cremdean Properties* were

UCTA, this guise of wording by ingenious draftsmen is brought within the protective measure under section 3(2)(b)(i) of the Act which prohibits the use of a term entitling a party to "render a contractual performance substantially different from that which was reasonably expected of him" unless the clause satisfies the requirement of reasonableness.[16] It is in this sense that UCTA has been said as also touching and controlling terms whose purpose is to "pre-empt", rather than exempt, the imposition of liability, by classifying the particular contract as of a type under which the relevant liability even does not arise in the first place.[17]

Indeed, courts are also active in preventing definitional clauses. The Court of Appeal, in *Phillips Products Ltd.* v. *Hyland*,[18] held that the effect and substance of a contract term must be looked at and that a clause which has the effect of "transferring liability from A to B necessarily and inevitably involves the exclusion of liability as far

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held not exclusion clauses). See also *Smith* v. *Eric S. Bush* [1987] 3 W.L.R. 889, discussed in part III, *infra*.

[16] For the view of the Law Commission, see Law. Com. No. 69, paras 143-146. The illustration given in their Report is the clause used by travel agents in *Angle-Continental Holidays Ltd.* v. *Typaldos Lines (London) Ltd.* [1967] 2 Lloyd's Rep. 61 which provided: "Steamers, Sailing, Dates, Rates, and Itineraries are subject to change, without notice".

[17] See David Tiplady, "*Some Problems with the Unfair Contract Terms Act 1977*", [1987] N.L.J 427. For a comprehensive discussion of this type of clauses, see Coote, *Exception Clauses*, (Sweet & Maxwell, 1964), Norman Palmer and David Yates, "*The Future of the Unfair Contract Terms Act 1977*", [1981] C.L.J. 108, at 123 *et seq*. For "shams" in contexts other than exclusion clauses, see Andrew Nicol, "*Outflanking Protective Legislation—Shams and Beyond*", (1981) 44 M.L.R 21 (describing shams and judicial response particularly in residential occupancy agreements).

Cf. the final words of section 13(1): "To the extent that this Part of the Act prevents the exclusion or restriction of any liability... , sections 2 and 5 to 7 also prevent excluding or restricting liability by reference to terms or notices which exclude or restrict the relevant obligation or duty". Obviously, this provision is also directed at the circumvention of the Act by means of "definitional" clauses. However, it does not apply to section 3 now under discussion. It can, nonetheless, efficaciously forestall attempts to exclude tortious liability and evade section 2 by the stipulation to the effect that the duty of care, which normally presupposes tort, is not owed to the persons concerned in the first place. See Lord Templeman's opinion, on this issue, in *Smith* v. *Eric S. Bush* [1990] 1 A.C. 831 at 848, that to conclude that such a clause is not an exclusion clause would "emasculate" the manifest intention of UCTA. See also *Johnstone* v. *Bloomsbury Health Authority* [1992] Q.B. 333 (C.A.) (an express term in an employment contract between a junior doctor and a hospital providing that the doctor could be called to work excessive hours (which could damage the doctor's health) was held to be falling within the final part of section 13(1)).

[18] [1987] 1 W.L.R. 659.

as A is concerned".[19] Therefore, in the instant case, a clause contained in a contract for the hire of a J.C.B. excavator and driver which provided that drivers and operators shall for all purposes be regarded as the servants or agents of the hirer who alone shall be responsible for all claims was held an unreasonable exclusion clause and the hire company had to be vicariously liable when the driver, the first defendant, negligently drove the excavator into collision with the plaintiff-hirer's factory. It is evident that the clause was devised to negative the hire company's vicarious liability in tort.[20] This *ratio decidendi*, however, equally applies to contractual liability in general.

3.2 Relationship between Section 3 and the Doctrine of Fundamental Breach or Breach of Fundamental Terms

As has been discussed, clauses excluding or restricting liability for breach of contract are controlled by UCTA through the requirement that they satisfy the reasonableness test. This bears some connection with two common law doctrines prior to the enactment of the Act—the doctrine of breach of a fundamental term and the doctrine of fundamental breach. A breach of a fundamental term (i.e. a term which is essential to the very core and essence of a contract) exists when the obligation which underlines the fundamental nature (the essence and base) of the contract has not been

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[19] [1987] 1 W.L.R. 659, per Slade L.J. at 665, 666. But a compromise or release of existing claims has been held in *Tudor Grange Holdings Ltd.* v. *Citibank N.A.* [1992] All E.R. 53 at 64-67, not to be an exclusion clause within the meaning contemplated by UCTA.

[20] It is noted that *Phillips Products Ltd.* v. *Hyland* [1987] 1 W.L.R. 659 was distinguished in *Thompson* v. *Lohan (Plant Hire) Ltd.* [1987] 1 W.L.R. 649. The clause in the latter was identical to that in the former but the injury caused by the excavator-driver, in the latter, was not caused to the hirer but to a third party (the hirer's employee) who died as a result of that driver's negligence. The hire company, liable to pay damages to the deceased's wife, then sought to rely on the clause to recover the damages from the hirer who contended that that clause was an invalid exclusion clause. It was held that UCTA dealt with exclusion as between the *proferens* and the victim and that when the victim in the instant case was the third party, not the hirer, the hirer argument failed. With respect, this decision can be criticised as incorrect. Although the hirer in *Thompson* v. *Lohan* was not the direct victim, this hirer became the "victim" once the hire company sought to recover from the former the damages paid to the third party. In this connection, Macdonald argued that the hirer in this situation could have resort to section 4 (the "indemnity clause" provision) since it was the case in which a person (the hirer) was required to indemnify "another person" (the hire company) in respect of liability of the person to be indemnified (the hire company) which was caused to "someone else" (the deceased): see *op. cit.*, (footnote 3, *supra*). Notwithstanding this possibility, there is, indeed, no need to retain section 4 if the case law in *Phillips* v. *Hyland* can apply to the situation in *Thompson* v. *Lohan* as well.

performed at all or performed not in its essential respect, so that such performance has become "something totally different from that which the contract contemplates".[21] The courts have also perceived of the failure of performance in the essential respect as the total failure of consideration, for the promisee obtains no part of the benefit intended by the contract. On the other hand, in the case of a fundamental breach, the promisor has already performed the essential obligation contemplated by the contract but the performance is still deficient and the promisee is consequently deprived of the intended benefit which would otherwise have been obtained from that contract, as can be illustrated in the case where a carrier in a contract of carriage has carried the goods to the destination but has deviated from the contract voyage. It has been a rather settled view that a contract terminates automatically upon a breach of a fundamental term while in the case of a fundamental breach the contract survives unless expressly terminated by the innocent party (that is, that party has an option to affirm or repudiate the contract). Firms have usually sought to exclude or restrict liabilities for these types of breaches. The consequence of such an exclusion is, therefore, at issue.

The fact that a contract comes or may come to an end following a breach of a fundamental term or a fundamental breach has an important impact on the survival of exclusion clauses contained therein. Of course, this issue does not arise if the innocent party seeks to recover in a *quasi-contract* action without having to rely on the contract. Under English law, this type of action is allowed, at least, for the recovery of the money paid in advance (money had and received).[22] But, if the innocent party wishes to bring an action in *contract*, which is typically the case when damages are sought, the implication of exclusion clauses will thus come into play.

In the category of a breach of a fundamental term, the "automatic termination" concept may, at first blush, lead to the thinking that all terms including exclusion clauses would fail accordingly. However, recent authorities seem to propound the view

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[21] Per Devlin J. in *Smeaton Hanscomb* v. *Sassoon I. Setty* [1953] 1 W.L.R. 1468, at 1470. An example of this breach is the case where a seller in a contract to sell peas delivers beans instead of peas.

[22] See dicta to this effect in *The Fibrosa* [1943] A.C. 32, per Viscount Simon L.C., at 46. See also *Maskell* v. *Horner* [1915] 3 K.B. 106.

that such termination will bring the contract to an end not *ab initio* but *de futuro* in the following sense: the innocent party is relieved from his obligation as to further performance while the guilty party's obligations and right to further performance are also at an end but replaced by a secondary obligation to pay damages for loss resulting from failure to perform the primary obligations; however, all matters leading up to the breach including the breach itself remain governed by contract terms including exclusion clauses.[23] Based on this "future obligations" approach in regard to the automatic termination, exclusion clauses can still be effective. To avoid this result, early authorities appeared to formulate an exceptional rule of law that when there was a breach of a fundamental term, the guilty party could not rely on an exclusion clause notwithstanding its presence.[24] However, it has been decided by the House of Lords in more recent cases that there is no such rule of law and that if an exclusion clause cannot be relied upon against the innocent party in the event of this type of breach, it is as a matter of construction of the clause itself, not as a matter of law. In effect, the cases in which the House of Lords enunciated this position concerned fundamental breaches but the judicial proclamations were apparently intended to be applicable to a breach of a fundamental term alike,[25] as will be explained below.

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[23] This position has been clearly enunciated by Lord Wilberforce and Lord Diplock in *Photo Production Ltd.* v. *Securicor Transport Ltd.* [1980] A.C. 827, at 844, 850. Although it was expressed in the light of the termination of contract in the event of a "fundamental breach", the expressions were obviously intended to apply with equal force to the context of a breach of a fundamental term as well since their Lordships were of the opinion that the same rule, as far as exclusion clauses were concerned, should apply to both types of breaches. Particularly of note is that Lord Wilberforce, *ibid.*, at 844, spoke of this matter in the context of "a breach of contract", implying the coverage of all types of breaches. The fact that the same rule applies to both types of breaches has often resulted in the doctrine of fundamental breach and the doctrine of breach of a fundamental term being canvassed altogether under the same heading "fundamental breach": see, for example, Law. Com. No. 69, paras 41-43.

[24] See, for example, *Pinnock Bros.* v. *Lewis & Peat Ltd.* [1923] 1 K.B. 690 per Roche J. at 696 (exclusion clause was held inapplicable when the goods delivered were "a substance quite different from that contracted for"); *Karsales (Harrow) Ltd.* v. *Wallis* [1956] 1 W.L.R. 936 per Birkett L.J. at 942 and per Parker L.J. at 943; *Yeoman Credit Ltd.* v. *Apps* [1962] 2 Q.B. 508 per Holroyd Pearce L.J. at 520 (the defects of a car, when taken *en masse*, were so grave as to constitute a non-performance or breach going to the root of the contract and an exclusion clause, though susceptible of protecting the seller in respect of a single defect, could not give protection to breaches which were "destructive of the whole essence of the contract").

[25] It is noted that Lord Wilberforce's discussion of this issue obviously referred to a fundamental breach, a breach of a fundamental term, or, in his words, "indeed to any breach of contract": see [1980] A.C. 827, at 843.

As with cases concerning breaches of fundamental terms, it was thought that the party who has committed a fundamental breach could not be protected by an exclusion clause as a matter of law.[26] The House of Lords, first in the leading shipping case of *Suisse Atlantique Société d'Armement Maritime S.A.* v. *N.V. Rotterdamsche Kolen Centrale*,[27] decided in rejection of this rule of law and took the view that the inapplicability, if any, of an exclusion clause following a fundamental breach was because of a rule of construction based on the presumed intention of the parties, regardless of whether the contract was repudiated or affirmed by the innocent party. This rule has later been affirmed and explained by the House of Lords in *Photo Production Ltd.* v. *Securicor Transport Ltd.*[28] and has stood as good law up till now. It follows, therefore, that if express and clear words are used to the effect of deliberately excluding or restricting liability in the event of a fundamental breach (or, too, a breach of a fundamental term, as the case may be), such intention must be observed and the *proferens* be exonerated from liability. The House of Lords in this case has, *inter alia*, endorsed this approach in holding that liability in question was excluded.[29]

Now, it should be recalled that UCTA does not outright prohibit exclusion or restriction of liability for breach of contract but merely subjects such a clause to the reasonableness test—the test which, as explained below, requires the consideration of

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[26] *Charterhouse Credit Co. Ltd.* v. *Tolly* [1963] 2 Q.B. 683 (C.A).

[27] [1967] 1 A.C. 361. The House of Lords agreed with Pearson L.J.'s view expressed in *U.G.S. Finance* v. *National Morgage Bank of Greece* [1964] Lloyd's Rep. 446, at 453.

[28] [1980] A.C. 827, overruling *Charterhouse Credit Co. Ltd.* v. *Tolly* [1963] 2 Q.B. 683 (C.A.); *Harbutt's "Plasticine" Ltd.* v. *Wayne Tank and Pump Co. Ltd.* [1970] 1 Q.B. 447, (C.A.) and *Wathes (Western) Ltd.* v. *Austins (Menswear) Ltd.* [1976] 1 Lloyd's Rep. 14 (C.A.).

[29] *Ibid.*, per Lord Wilberforce, at 846. See also *R.W. Green Ltd.* v. *Cade Bros. Farms* [1978] 1 Lloyd's Rep. 602 at 608, 609 (a clause limiting compensation for breaches, including breaches of implied conditions as to quality and fitness for the purpose as to which Griffiths J. regarded as breaches of fundamental terms, to the contract price of the goods was held effective to cover the event where the crop failed owing to virus Y in the seeds since this coverage was clearly intended by the parties, given that the buyer-farmers chose to buy uncertified seed potatoes rather than certified goods which were available at a little higher price and thus must have anticipated a chance that those seeds would be infected. *Cf. Levison* v. *Patent Steam Cleaning Co. Ltd.* [1978] 1 Q.B. 69 (C.A.), at 80 (a clause, used by carpet cleaners, providing that all merchandise was accepted "at the owner's risk" was held, as a matter of construction, to cover merely loss or damage caused by negligence).

all circumstances including the intention of the parties. This manifests the Act's preservation of the rule of construction in regard to the inapplicability of the exclusion clause concerned.[30] However, UCTA has gone beyond this construction canon in that even though an exclusion clause can be interpreted as already covering the loss in question it can be struck down if the court is not satisfied that it is reasonable.

3.3 Application to "Consumer Contracts" and Written Standard Terms of Business

The enactment of UCTA was intended to be an instrument of consumer protection. Most of UCTA's provisions subject exclusion clauses or similar clauses[31] to judicial scrutiny when such clauses are sought to be enforced against "a person dealing as consumer"[32] or in relation to "consumer goods" (goods ordinarily supplied for private use or consumption).[33] Under the Act's definition, a party is treated as dealing as consumer in a contract with another when he does not make the contract in the course of a business and not hold himself out as doing so while the other party does make the contract in the course of a business.[34]

3.3.1 Contracts Not Concluded on Written Standard Terms of Business

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[30] It is worth noting that the Act, by section 9(1), also takes the *de futuro* approach as far as the termination (or, in the case of a breach of a fundamental term, automatic termination) of a contract following a breach is concerned. Section 9(1) provides: "Where for reliance upon it a contract term has to satisfy the requirement of reasonableness, it may be found to do so and be given effect accordingly notwithstanding that the contract has been terminated either by breach or by a party electing to treat it as repudiated".

[31] E.g. indemnity clauses under section 4.

[32] See ss. 3, 4, 6(2), 7(2).

[33] S. 5.

[34] No definition of "in the course of a business" is found in UCTA. However, judicial opinions delivered under other Acts, particularly Sale of Goods Acts, on the issue involving the identical phrase are likely to be followed by the courts deciding cases under UCTA. On the authority of *Ashington Piggeries Ltd.* v. *Christopher Hill Ltd.* [1972] A.C. 441, a person can be regarded as dealing "in the course of a business" even if it is the first time he deals with the goods concerned; and, as stated in *Buchanan-Jadine* v. *Hamlink* (1981) S.L.T. 60 which concerned a sale of an entire farm and livestock, will be treated as such even if the transaction in question disposes of the goods and stocks such as to terminate that business. See also the requirement of "regularity" at p. 167, *infra*.

Section 3, the key section of UCTA, is also based upon the consumer protection ideology. Under the provision, the distinction is made between a contract made on "written standard terms of business" (specifically speaking, a standard form contract)[35] and one made not in that fashion. In a contract made other than on written standard terms of business, section 3 applies as between contracting parties where one of them deals as consumer and the clause concerned is invoked against this party. The protection in the consumer context is obviously intended to exclude contracts between businessmen, or between two consumers, or between a business party and a consumer party when the consumer party is the *proferens*.

The exclusion of businessmen, or consumers who contract with other consumers from the statutory provision is justifiable and consistent with this thesis's analysis in Chapter 1. As far as businessmen are concerned, the objective theory of contract should shed light on placing them outside the scope of the statutory protection. Although the intention of the draftsmen, as gleaned from the Law Commission Report, regarding giving protection only to consumers (sometimes described by the Law Commission as "private individuals") seems to rest simply upon the perception that merchants can generally protect their interests and that only consumers tend to be vulnerable when making a contract,[36] this perception, in fact, bears close relevance to the "reliance" foundation of the objective theory of contract in the following sense: whereas a merchant is generally believed to be capable of looking after his interests when making a contract with another party, this belief leads that other party to believe further that the former is genuinely assenting to the terms concerned out of his rational judgment and ability to secure contractual benefits; and it is the reliance upon this consequent belief that induces that other party to enter into the contract.

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[35] Notably, Part II of the Act, which is applicable to Scotland, has chosen to use a more precise wording: "a standard form contract" in the equivalent section, section 17. In addition, the Law Commission's relevant discussion also referred, by and large, to standard form contracts: see Law. Com. No. 69, paras 151-157.

[36] Law. Com. No. 69, para 11.

Even though the Act intends to exclude business dealings from the protection against exclusion clauses, an authority is found from *Rasbora Ltd.* v. *J.C.L. Marine*[37] to the effect that a firm can be regarded as dealing as consumer (i.e. not in the course of a business) when the goods transacted are intended for the use of its members and not for resale. More recent cases[38] have emerged to endorse the position spelled out in *Rasbora's* case when the courts have decided that for a firm to be treated as dealing as non-consumer the transaction involved, if it is not clearly an integral part of the business carried on but is only incidental to that business, has to possess some degree of *regularity*. Based upon this requisite degree of regularity, the situation where a firm buys the goods for use in the firm itself or sells the goods on a casual occasion enables the firm to be still regarded as a consumer and then guarded against exclusion clauses. This position can be criticised as incorrect in the light of the rationale of ousting businessmen from the statutory protection. If this exclusion is justifiable on the grounds of a merchant's ability to guard his interest and the consequent creation of "reliance", as explained above, these grounds should maintain their merits and relevance irrespective of the purpose for which the goods or services are intended to be obtained.

It should be noted that the safeguard as embodied in section 3, the key section of UCTA, does not extend to the unsophisticated class of merchants—those who carry on "one-man" business or single trading. The significance of treating this class of businessmen as ordinary consumers seems to elude the draftsmen's contemplation. However, the above-mentioned case law which treats a merchant in an "incidental" transaction as a consumer can have the effect of protecting small businessmen as well.

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[37] [1977] 1 Lloyd's Rep. 645. Again, although this is a case on section 55(7) of the Sale of Goods Act 1893, the decision on the issue as to whether the sale in question was a consumer sale or non-consumer sale undoubtedly bears direct relevance to the determination as regards a business dealing or a consumer dealing under UCTA.

[38] See *Peter Symmons & Co. Ltd.* v. *Cook* (1981) 131 N.L.J. 758 (a purchase of a car by a firm of surveyors for the use of the firm); *Davies* v. *Sumner* [1984] 1 W.L.R. 405; *R. & B. Customs Brokers Co. Ltd.* v. *United Dominions Trust Ltd* [1988] 1 W.L.R. 321, per Dillon L.J. at 330, 331 (a purchase of a car by a freight forwarding and shipping firm for one of its directors' personal use as well as for the company's use). The last-mentioned case was decided directly on the phrase "in the course of a business" under section 12 of UCTA.

Nevertheless, this protection is as a matter of case law and does not emanate from the legislation itself. Moreover, it cannot be granted that this case law is adequate. It is of little sense to afford small businessmen protection only in respect of incidental transactions. A transaction which forms an "integral part" of the business carried on by this type of merchant should be protected against unfair clauses alike. Notwithstanding, as will be seen below, UCTA also protects businessmen in the event where the dealing is on written standard terms of business. As most contracts are nowadays in the form of standard form contracts, those unsophisticated or small businessmen who enter into a contract with commercially sophisticated firms are, in practice, still under the statutory safeguard.

As for a contract between two consumers, UCTA does not regard either party as dealing as consumer, with the consequence that such a contract will be cast out from the Act's protection. As already seen from Chapter 1, this thesis justifies the exclusion of a contract concluded under this setting from protection by means of statute on the ground that unfairness in the terms contained in this type of agreement can be more appropriately remedied under equitable rules. Nevertheless, the legislature seemed to justify it on a different ground. Supposedly, the draftsmen may simply have anticipated low incidence of exclusion clauses in the context of "two consumers" contracts.[39]

3.3.2 Contracts Concluded on Written Standard Terms of Business

Although UCTA has emerged from the consumer protection philosophy, with its key provision subjecting to judicial review exclusion clauses contained in general contracts only when the clauses are sought to be enforced against a party dealing as consumer, the Act has appeared to go beyond this consumer concern when it also allows the judicial inquiry into the reasonableness of exclusion clauses in the situation where such a clause is invoked against a business party *provided that the contract*

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[39] The Law Commission felt that the relationship between two persons who contracted in a purely private capacity was essentially a social one which was too unlikely to involve the use of exemption clause to give rise to concern: see Law. Com. No. 69, para 9. See also David Yates, *Exclusion Clauses in Contracts*, *op. cit.*, (footnote 3, *supra*), p. 106; Ian Brown, "*Business and Consumer Contracts*", [1988] J.B.L. 386, at 388-394.

containing it has been made on the other's written standard terms of business.[40] Under this provision, a commercial firm possessing high business expertise, or even a giant multinational corporation, which has made a contract on a standard form basis with the other party is as much entitled to claim that some contract terms sought to be enforced against it are unreasonable exclusion clauses as where those clauses are invoked against consumers.

Whatever reason on the part of the legislature for treating merchants in standard form contracts as, at the outset, equally safeguarded against exclusion clauses as consumers in general contracts, it is difficult to find justifications for it. If credence is given to the firm's or merchant's business experience, ability to secure business interests and the reliance on the part of the other party contracting with such firm or business party, this credence can hardly be lost simply by reason that a contract in question is concluded on a standard form basis or made subject to written standard terms of business. It is only the unsophisticated class of businessmen that can be justified in being regarded as general consumers.[41] Moreover, in the light of unsophisticated merchants, treating them as consumers *vis-à-vis* the safeguard against unfair contract terms should not be restricted to the situation where a contract is made on the other's party written standard terms of business. A one-man business owner or a single trader who has made a written but not standardised contract can equally be a victim of harsh clauses in such a contract. On the whole, the distinction between the consumer and business contexts as found in UCTA is, therefore, without sound conceptualisation and needs revision in its framework. The Act should *ab initio*

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[40] Section 3(1) provides: "This section applies as between contracting parties where one of them deals as consumer *or* on the other's written standard terms of business" (italic added).

[41] The Law Commission, it is observed, justifies extending protection even to a person acting in the course of a business on the ground that in many cases such a person is in a very similar position to a consumer. However, the example given to support this submission is a contract which a *small* shopkeeper makes with a magazine owner to advertise his goods and by which he is bound by the magazine's exclusion of liability for any errors in the advertisement. Apparently, only small businessmen have been envisaged by the Law Commission to be vulnerable: see Law. Com. No. 69, para 147. It is thus a puzzle that the rationale relating to small businessmen could eventually extend to sophisticated businessmen as well.

exclude business parties, with the exception of the unsophisticated class of them, from the statutory protection.

It may be argued that in practice sophisticated merchants are excluded from the operation of UCTA. This is because the Act's "reasonableness test", as will be discussed shortly in this chapter, requires the consideration of all circumstances at the time the contract was made.[42] Undoubtedly, business position, the size of enterprise, commercial experiences and other relevant factors are also to be taken into account. The investigation against these business backgrounds seems to attenuate the ultimate chance of success of a sophisticated business-party in vindicating the unreasonableness of a contested clause. Although the truism of this trend is not disputed here, it is submitted that it is more appropriate to exclude parties of sophisticated business standing from the legislative protection at the outset. Permitting litigation by this class of merchants in relation to unfair contract clauses would also unwisely incur the cost of administration of justice not only without visible merit but also in the face of the sound foundation of the objective theory which has long stood as the headstone of the contract law.[43]

4. Reasonableness Test: Substantive Unfairness Test?

4.1 Overview

As UCTA requires that contract terms as specified by section 3 be "reasonable", the Act, by section 11, sets out the "reasonableness test". According to the test, a term satisfies the requirement of reasonableness when it is "a fair and reasonable one to be included having regard to the circumstances which were, or ought reasonably to have been, known to or in the contemplation of the parties when the contract was made".

The wording employed in the legislation to describe reasonableness may, at first sight, generate confusion when the phrase "fair and reasonable" itself is chosen to

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[42] S. 11 and Schedule 2.

[43] See also the similar comment on U.C.C. § 2-302 in Chapter 4, *infra*.

determine reasonableness, thereby amounting to the description of one thing by reference to the same thing, with the result that the purpose of description can hardly be achieved. However, the Act directs that regard be had to the circumstances at the time of the execution of the contract and it is the consideration of all surrounding circumstances which is the benchmark of the test.

Circumstances to be reckoned with by the courts for the determination of reasonableness of a contract clause are open-ended. However, in respect of disclaimers of implied conditions as to correspondence of goods with description or sample or as to their quality or fitness for a particular purpose which are contained in contracts for sale, hire-purchase (and analogous contracts under which goods pass) and invoked against a person not dealing as consumer, UCTA additionally specifies special matters to be particularly taken into account in determining whether such clauses satisfy the requirement of reasonableness. These matters, as set out in Schedule 2 to the Act, are the following:

> (a) the strength of the bargaining positions of the parties relative to each other, taking into account (among other things) alternative means by which the customer's requirements could have been met;
> (b) whether the customer received an inducement to agree to the term, or in accepting it had an opportunity of entering into a similar contract with other persons, but without having to accept a similar term;
> (c) whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any custom of the trade and any previous course of dealing between the parties);
> (d) where the term excludes or restricts any relevant liability if some condition is not complied with, whether it was reasonable at the time of the contract to expect that compliance with that condition would be practicable;
> (e) whether the goods were manufactured, processed or adapted to the special order of the customer.

Although theses matters are merely specified as special matters which have to be considered in determining disclaimers of such statutorily implied undertakings, it is submitted that they, perhaps with the exception of the matter (e) which is peculiar only to disclaimers of such statutorily-implied undertakings as stated by the Act, are likely to be also taken into account when the courts determine reasonableness of general

exclusion clauses under UCTA's provisions including section 3.[44] The Act only requires that the courts have particular regard to these matters when considering reasonableness of such disclaimers in contracts of sale or hire-purchase or analogous contracts under which goods pass. UCTA does not prevent these guidelines from being applied to the determination of reasonableness of general exclusion clauses encompassed by the Act. Inarguably, if these guidelines had not been listed as special guidelines applicable to particular provisions, they could be applied as part of the "circumstances" under the Act's general test of reasonableness nonetheless. Indeed, the courts in many cases usually regard these guidelines as being of general application to the question of reasonableness under UCTA.[45]

Likewise, in respect of the restriction of liability to a specified sum of money, UCTA, under section 11(4), sets out another two factors to which particular regard shall be had when considering whether such restriction is reasonable. These additional factors are the particular availability of resources and possibility of insurance cover for the purpose of meeting the liability intended to be restricted. By parity of reason, the factors can form part of the "circumstances" under the Act's general test of reasonableness as well.

4.2 Prescribing Procedural Rather Than Substantive Unfairness

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[44] See Cheshire, Fifoot and Furmston, *Law of Contract*, 12th edn., (Butterworths, 1991), pp. 187-188; G.H. Treitel, *The Law of Contract*, 19th edn., (Sweet & Maxwell: London, 1995), p. 237. See also M.P. Furmston, "*The Unfair Contract Terms Act 1977 and the European Directive on Unfair Term in Consumer Contracts*", (1994) 25 Buying and Selling Law Special Report 1, at 7.

[45] See, in particular, *Stewart Gill Ltd.* v. *Horatio Myer & Co. Ltd.* [1992] 2 All E.R. 257, per Lord Donaldson M.R. at 261 and per Stuart-Smith L.J. at 262. See also *Singer Co. (U.K.) Ltd.* v. *Tees and Hartlepool Port Authority* [1988] 1 Lloyd's Rep. 164 at 169. In *Phillips Products Ltd.* v. *Hyland* [1987] 1 W.L.R. 659 (C.A.) concerning a clause in a contract of hire of an excavator and driver which had the effect of excluding the hire company's vicarious liability for the driver's negligence, the Court of Appeal, per Slade L.J., addressed the opinion that the Guidelines in Schedule 2 would also fall to be considered in this cased because the contract in question was a contract of hire which was the contract under which possession of the goods passed and, therefore, section 7(3) of UCTA and its Schedule were rendered applicable. In effect, although section 7(3) applies to contracts involving the passing of ownership or possession of the goods, its applicability is restricted to such particular disclaimers as specified by the section. As the exclusion clause in *Hyland* was not any of these specific disclaimers, it would be wrong to say that the applicability of Schedule 2 to the contract in this case was because the clause in question fell within section 7(3). The court should have held that Schedule 2 applied to this case by way of analogy or by way of its forming part of "the circumstances".

Although UCTA can generally be seen as dealing merely with unfair exclusion clauses rather than unfair contract terms, little attempt on the part of the legislature has been made to set out sharp guidelines for the determination of an "unfair character"—substantive unfairness—of a clause concerned. It was felt by the Law Commission that substantive factors relevant to reasonableness might be too various to be listed.[46] It is noted that most of the factors listed as guidelines in Schedule 2 are indicative of procedural unfairness. These, in particular, include the matters in subsections (a), (b) and (c) mentioned above, which will be elaborated upon shortly. It is therefore, visualised that no distinction is systematically made, under UCTA, between procedural unfairness and substantive unfairness of a contract clause. Instead of prescribing appropriate procedural unfairness as a pre-condition for filing a claim requesting the court to inquire into the substantive reasonableness of a clause concerned, the legislature has chosen to merge procedural unfairness into the consideration of substantive unfairness of the clause. In addition, some of the procedural factors outlined in Schedule 2 are irrelevant, as will be demonstrated below.

(a) The Relative Bargaining Position and Availability of Alternatives

Subsection (a) of Schedule 2 directs the court to have regard to "the strength of the bargaining position of the parties relative to each other, taking into account (among other things) alternative means by which the customer's requirements could have been met". With regard to the "bargaining strength" (or inequality of bargaining power) consideration in order to vindicate reasonableness, if it is directed at the "take-it-or-leave-it" situation it is obviously fallacious and runs counter to business convenience and economic utility in the era of modern markets[47] which dictate most

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[46] See Law Com. No. 69, para 185. The Law Commission's recommendation for the lack of list also stemmed from the trepidation that the omission of a matter which may well be relevant in a particular case may wrongly carry the implication that it should be disregarded and, similarly, the inclusion of particular matters may incorrectly attract more importance than they merit: *ibid.* This anxiety can be criticised as meagre since a solution to this problem can simply be arrived at by means of a clear mention in the legislation that the guidance given shall not preclude judicial heed of other matters. This will be dealt with at full length in Chapter 6, *infra*.

[47] That is so even though the Law Commission has suggested that the courts should take account of the "commercial and social realities of the situation" in determining reasonableness: see Law. Com. No. 69, para 190. See also para 55 (discussing "social and commercial expediency" grounds).

firms to use, in dealing with customers, standard forms containing standard terms generally not open to an individual customer to negotiate for change. If a clause could be declared unreasonable on this footing, the economic advantages of form contracts, which we have already discussed in Chapter 1, would be ravaged. "Unreasonableness" of a contract clause should, therefore, lie in any determinable factors other than the "adhesive" character of a contract.[48] In order to avoid misconception, it must be clearly stated, however, that this thesis is not suggesting that "inequality of bargaining power" is of no relevance in terms of procedural unfairness. It should be noted that "inequality of bargaining power" is an expression capable of carrying both narrow and broad senses. Its narrow sense connotes the adhesive feature of a contract while the broad sense embraces such factors as relative sophistication or knowledge of the parties.[49] It is in the former sense that the relevance of "inequality of bargaining power" is denied by this thesis. Nonetheless, it is suggested that where such factor as the lack of knowledge or understanding of contract terms is the decisive factor *vis-à-vis* procedural unfairness, it should be candidly stated in its own identity rather than obscurely expressed by reference to the "inequality of bargaining power" locution. Apparently, such a treatment helps elucidate the real ground of the courts' decisions.

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[48] See Law. Com. No. 69, paras 11, 147-156 for the discussion on this issue. For better understanding of the irrelevance of "inequality of bargaining power" in the light of the take-it-or-leave-it character of a contract, see the discussion of "oppression as take-it-or-leave-it" under U.C.C. § 2-302 in Chapter 4, pp. 220 *et seq.*, *infra.*

[49] It is noted that the use of this term in its broad sense has, in England, once found a manifestation in Lord Denning's judgment in *Lloyds Bank* v. *Bundy* [1974] 3 All E.R. 757 discussed in Chapter 2, *supra. Cf.* American cases, discussed in Chapter 4, *infra.* It will be shown that when American courts stated inequality of bargaining power as a decisive factor of unconscionability under U.C.C. § 2-302, most courts were concerned with sophistication or knowledge of the parties. It is also found that scholars in other jurisdictions have often used the term in the above-mentioned sense. For instance, Woftgang Freiherr von Marschall, in "*The New German Law on Standard Contract Terms*", [1979] L.M.C.L.Q. 279 at 282, has addressed: "The basic reason for giving special protection against clauses in standard terms is the weaker bargaining power of one party. Such weaker bargaining power may simply be the result of economic inequality.. . *But frequently the weaker bargaining power of one party is caused by his inexperience in the field. It may simply be lack of experience in business matter... . It may equally be inexperience in legal matters which prevents him from fully appreciating the meaning and potential effect of certain clauses*" (italics added). Based on this, he believes that section 3 of the Standard Terms Act 1976 (the provision which deals with "unusual terms") can give protection in this field.

As for the factor concerning alternative means available to customers, the wording may encapsulate two situations, viz. (1) monopoly (2) availability of differential price quotation. As expounded in Chapter 1, in the context of consumer goods, monopoly seems too rare to call for its inclusion in the statutory check-list of reasonableness of a contract term. Regarding the "differential price quotation" consideration, it comes into play when it is found that better terms have been offered at a higher price but a consumer has chosen to contract on less favourable terms in view of a lower price. It can, therefore, be seen that UCTA intends to preclude consumers in this situation from claiming that those unfavourable, but deliberately and voluntarily acceded to, terms are unfair. Indeed, this consideration can also be found in reported cases.[50] In effect, this is the situation involving "benefit-based" substantive unfairness *per se* which, as this thesis has already discussed in Chapter 1,[51] should not be meddled with by the courts. Given this, the notion of non-interference with substantive unfairness *per se* can also be found in UCTA although the Act does not make an explicit mention of it. Nevertheless, as Chapter 1 has also revealed, there are, apart from the situation involving the "benefit consideration", a number of situations in which unfavourable terms of a contract will amount to substantive unfairness *per se*. UCTA's framework should have appropriately been designed to preclude all of these situations from judicial rewriting. Of course, there will be no need for the Act to provide a full list of situations representative of substantive unfairness *per se*. Such a preclusion can simply be achieved as long as the Act requires appropriate procedural impropriety as a pre-condition for a claim of substantive unfairness or

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[50] See, for example, *Stevenson* v. *Nationwide Building Society* (1984) 272 E.G. 663 where a purchaser (of a commercial property)'s contention that the Building Society's disclaimer of liability for negligence in making a mortgage valuation report was unreasonable failed since, *inter alia*, he was offered a better service at an extra cost but deliberately chose the cheaper option (see footnote 54, *infra*, for the discussion of this case on another issue); *R.W Green Ltd.* v. *Cade Bros Farms* [1978] 1 Lloyd's Rep. 602 at 608, 609 where merchant-farmers were held bound by the sellers' restriction of liability to the price of the seeds sold since, *inter alia*, they deliberately bought uncertified seeds when certified goods were available at an extra cost. The latter case was decided under sections 55(4) and (5) of the Sale of Goods Act 893 which is the precursor of UCTA provisions insofar as the exclusion of the particular statutorily-implied conditions is concerned, hence the relevance of the decision to UCTA. See also the relevant view of the Law Commission alluded to at footnote 6, *supra*.

[51] See the discussion of "benefit consideration" in Chapter 1, *supra*.

unreasonableness of a contract clause or spells out candidly, at least, that both types of unfairness must be found for a clause to be declared unreasonable.

(b) Inducement and Opportunity of Entering into a Similar Contract with Other Persons without a Similar Term.

Another guideline, embodied in subsection 2 of Schedule 2, for the determination of "unreasonableness" is "whether the consumer received an inducement to agree to the term, or in accepting it had an opportunity of entering into a similar contract with other persons, but without having to accept a similar term". The substance of this guideline solely concerns procedural impropriety. It is evident that the element involving inducement to agree to the term, if it is intended to depict situations other than that concerning the common law misrepresentation, could perhaps encompass the situation where advantage has been taken of the circumstances of weaknesses of the other party.

Again, it is submitted that this should be more appropriately left under the operation of the equitable doctrine. As pointed out in Chapters 1 and 2, while the doctrine has been expanded elsewhere, to encompass a wide range of one party's circumstances of weaknesses of which advantage can be taken by the other party, its operation in England is still limited to being "*a poor and ignorant person*". It might, at first sight, be argued that the insertion of the "inducement" factor in UCTA's guidelines is a praiseworthy development. In reality, this argument can only be a half-truth. We have already explained in Chapter 1, and will further demonstrate (against the empirical experience in the United States) in Chapter 4, that lumping together factors relating to the advantage-taking and factors not involving the advantage-taking under the criteria for the determination of "unfairness" or "unreasonableness" of a contract term will increase the level of abstraction in judicial reasoning. It is, therefore, more wise to develop the equitable doctrine, by means of legislation, under a different general rule.

Now, with regard to the availability of an opportunity of entering into a similar contract with other persons but without having to accept a similar term, a few possibilities are discernible under this criterion. First, it may apply to monopoly. In

respect of nation-wide monopoly, relevant arguments previously addressed in this thesis come into play here. A situational monopoly can also fall within this guideline. As a situational monopoly in a salvage agreement is already dealt with by the peculiar rule allowing judicial rewriting of a rescue fee to a reasonable sum, it might be argued that this guideline has a role to play in other types of situational monopoly. However, although the victim of a situational monopoly other than in a salvage agreement remains unremedied by English common law and equity, it is the situation which involves the advantage-taking of the circumstance of weakness and, again, needs rectification under a separate general rule. Another contingency is perhaps the situation where a contracting party has deliberately decided not to "shop around" for better terms and, instead, chosen to accede to the contract concerned with willingness to accept the risk of loss. It can be here restated that this is the situation representative of substantive unfairness *per se*, which, in reality, needs no particular mention if the Act simply requires procedural unfairness as a pre-condition for claiming that a contract term is unfair in its ultimate result.

(c) The Parties' Knowledge of the Existence of Contract Terms

In determining "reasonableness", the courts must also take into account "whether the customer knew or ought reasonably to have known of the existence and extent of the term (having regard, among other things, to any customs of the trade and any previous course of dealing between the parties)". Apparently, this is an important criterion and is responsive to modern market conditions as far as the prevalence of the informational asymmetry problem is concerned. It is evident that the focus of this guideline is placed on the parties' state of knowledge of the "existence and extent" of the contract term concerned. Therefore, the prevention by transaction haste from obtaining the knowledge that a particular term is included in a contract is recognised and the undesirable loophole left by the common law doctrine of reasonable notice, as well as the rule in *L'Estrange* v. *Graucob Ltd.*[52] has now been filled by UCTA.

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[52] [1934] 2 K.B. 394.

However, as UCTA deals only with exclusion clauses, the insufficiency of these common law doctrines is still left intact in the context of general contract terms.

A question may be raised as to whether this UCTA guideline, in addition to its recognition of the parties' lack of knowledge of the "existence" of contract terms, has also recognised the lack of "understanding" of complex clauses and language. As the guideline speaks of the knowledge of the "existence and extent" of the term, it is not clear-cut whether the knowledge of the "extent" of the term can be interpreted as including the knowledge of the effect (or implication) of a contract clause. On the one hand, the term "extent" may be discerned as the reiteration of the term "existence" so as to jointly connote the incorporation rather than the meaning or understanding of the clause concerned. However, recent cases decided under UCTA have taken heed of the parties' comprehension of the clause when determining its reasonableness. In *The Zinnia*,[53] Staughton J. held exemption clauses in question unreasonable both because "they are in such small print that one can barely read them" and because "the draftsmanship is so convoluted and prolix that one almost needs an LL.B. to understand them". The fact that the learned judge considered the visibility and comprehensibility of the terms together carries the implication that the court perceived the wording in guideline (c) as including the parties' understanding of the clause. Alternatively, the judicial heed of the parties' comprehension may be perceived of as the consideration of the "circumstances" under the general test.[54] This being so, the significance of the question as to whether the lack of understanding of contract clauses falls under UCTA's special guideline or general guideline is more academic than practical. Moreover, it is clear from the Law Commission Report that the case for the control of exclusion clauses, as advocated by them, includes both the party's ignorance

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[53] [1984] 2 Lloyd's Rep. 211.

[54] Also, in *Stevenson* v. *Nationwide Building Society* (1984) 272 E.G. 663, it was held that a Building Society could rely on the disclaimer of liability for loss caused by the negligence of their valuer in preparing a mortgage valuation report, *inter alia*, because Mr. Stevenson, the purchaser, admitted that he understood its meaning. See also *Phillips Products Ltd.* v. *Hyland* [1987] 1 W.L.R. 659 (discussed at p. 184 *infra*; *Smith* v. *Eric S. Bush* [1987] 3 W.L.R. 889 per Dillon L.J. at 897 (discussed at p. 188 *infra*).*Cf.* Dillon J.'s view in *Walker* v. *Boyle* [1982] 1 All E.R. 634 (discussed at footnote 77, *infra*).

of the presence of the contract term and his inability to appreciate its meaning.[55] However, it must be pointed out again that this legislative recognition of this type of informational asymmetry does not go beyond the context of exclusion clauses.

4.3 Substantive Unfairness

As previously mentioned, little attempt has been found in UCTA to really set out "unfair character"—substantive unfairness—of a contested exclusion clause. The guidelines (a)-(c) in Schedule 2 are directed at procedural unfairness. Although procedural impropriety has often been employed to achieve substantive unfairness, not all procedurally flawed contract terms are unfair or unreasonable in their end result. Outlining procedural improprieties as, seemingly, part of the test of (substantive) reasonableness without clearly specifying them as the pre-condition for the judicial inquiry into the unfairness in the result of the clause concerned may erroneously encourage the conclusion that a clause is unreasonable and destructible simply because, for example, the protesting party did not know of its existence at the time of the contract.

For the UCTA framework to be conceptually sound, the Act must require that the courts, when satisfied that some procedural wrong was present at the time the contract was made, look into the substance of the clause concerned to determine whether it produces any unfair result. Sharp and appropriate guidelines should also be provided as to what constitutes this type of unfairness. In this regard, very few criteria for the determination of an unfair character of a contract clause are specified under UCTA. The guideline (d)[56] in Schedule 2 can, perhaps, be discerned as indicative of substantive unfairness. Under this guideline, a clause can be declared substantively unreasonable if it requires a contracting party to comply with some condition which is unnecessary and its compliance is not practicable. Another indicator of a substantively unfair clause is the availability of insurance cover and the financial resources for meeting the liability. This is set out in section 11(4) which applies to a clause

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[55] Law Com. No. 69, para 11. See also para 147 in connection with standard form contracts.

[56] See the quoted wording at p. 171 *supra*.

restricting liability to a specified sum of money. [57] In effect, the relevance of this criterion can also extend to other types of exclusion clauses and can even apply to contract terms outside the exclusion clause context. For instance, substantive unconscionability of the "add-on clause" used in *Williams* v. *Walker-Thomas Furniture Co.*[58] discussed in Chapter 1 could be considered, *inter alia*, in the light of this matter as well.

As our earlier discussions indicate, three types of exclusion clauses have been listed to be within the ambit of UCTA's key provision—section 3. These are (1) a clause excluding or restricting liability for breach of contract, (2) a clause entitling a party to render a contractual performance substantially different from that which was reasonably expected of him and (3) a clause allowing a party to render no performance at all. It is noted that clauses in the category (2) and (3) exhibit *in themselves* an unfair character in the substantive dimension.[59] It follows, therefore, that the requirement that such a clause satisfy the reasonableness test can only be perceived of as the mandate for the inquiry into the procedural impropriety of the clause. (In this connection, it should be recalled that most of the guidelines for the application of the reasonableness test are directed at procedural improprieties.) However, exclusion clauses in the category (1) above, which seemingly represent the majority of exemption clauses, do not by themselves exhibit unfairness in the result. The substance of a particular clause needs to be looked at in order to determine whether it is substantively unfair. It is in this respect that the courts are not much assisted by the guidelines under UCTA in making the determination *vis-à-vis* unreasonableness.

III: SIGNIFICANT CASES DECIDED UNDER UCTA REVISITED

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[57] See cases discussed in part III, *infra*. For the Law Commission's opinions on the relevance of insurance to the contract term control policy, see Law. Com. No. 69, para 56.

[58] (1965) 350 F.2d. 445.

[59] In particular, a clause which entitles a party to render no performance at all is manifestly illusory. See also the discussion of "self-evident" substantive unfairness, *infra*.

A number of cases decided under UCTA have previously been alluded to in this thesis's discussions of UCTA's framework and guidelines. In this section, some cases of particular significance, especially those at the appellate level, will be re-examined. It must be said at the outset that although some cases which will be discussed shortly concerned exclusion of liability in *negligence* or *misrepresentation*, the courts' decisions as regards unreasonableness of the clauses concerned are reflective of judicial accounts of unreasonableness *vis-à-vis* clauses exempting liability in *contract* as well. Also, although many cases concerned contracts between businessmen (and it should be recalled that this thesis has argued for the exclusion of this class of persons from statutory protection), it is submitted that those facts which the courts have taken into consideration in deciding on unreasonableness of the clauses in question would be the matters the courts would reckon with when determining whether disclaimers in consumer contracts are reasonable.

As the Act's guidelines for the application of the reasonableness test principally concern procedural improprieties, the courts in many cases seemed to rely on procedural factors in arriving at the conclusion whether the clause in question was reasonable. Nevertheless, a few indicia of unreasonableness in the substantive dimension (i.e. substantive unfairness) can be extracted from the courts' delivery of judgments even though those criteria have not been spelled out explicitly.

Six years after UCTA came into force, the House of Lords, in *George Mitchell (Chesterhall) Ltd.* v. *Finney Lock Seeds Ltd.*,[60] had the first opportunity to decide on the reasonableness of conditions, in a contract of sale of Late Dutch Special cabbage seeds between seed merchants and merchant-farmers at the price of £201.60, which limited the sellers' liability to the seeds' replacement or refund of the price paid if the seeds sold or agreed to be sold did not comply with the express terms of the contract or proved defective in varietal purity and excluded all liability for consequential loss as well as any express or implied condition, statement or warranty, statutory or otherwise. The seeds supplied were not late cabbage and were unmerchantable,

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[60] [1983] 2 A.C. 803 (H.L.).

causing the loss of over £61,000 to the farmers when they were planted, germinated and grew but were commercially useless and had to be ploughed in. The House of Lords first held that the conditions in question, on their true construction, were clear and unambiguous enough to cover the circumstance where the seeds were defective. The House of Lords then moved to determine whether it was fair or reasonable, within the meaning of section 55(4) and (5) of the Sale of Goods Act 1979 as modified by paragraph 11 of Schedule 1 thereto, to allow reliance on these conditions. It is of note that the decision as to reasonableness in this present case had to be based on the Sale of Goods Act 1979 rather than UCTA because the sale was made before February 1, 1978, the date when UCTA came into force.[61] However, as the criteria for the determination of fairness or reasonableness in this modified section 55(5) are identical in substance to those guidelines set out in Schedule 2 to UCTA, the approach taken by the House of Lords *vis-à-vis* reasonableness of an exclusion clause is undeniably authoritative on UCTA cases as well (and it is for this reason that *George Mitchell* has often been referred to as an UCTA case).[62]

As section 55(5)(c) directs the courts to have regard to the knowledge of the buyer of the existence and extent of the term, the House of Lords thought that the fact that the buyers admittedly knew of the relevant conditions and, when coupled with many years of dealing between the parties, had no difficulty in understanding their implications may, at first sight, weigh in the scales in the sellers' favour. But, in the House of Lords' view, other crucial factors tipped the scales in the buyers' favour. First, the limitation of liability was universally embodied in the standard terms of seed trade and had never been negotiated between representative bodies. Secondly, and

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[61] In this connection, section 55 of the Sale of Goods Act 1979 provides that a right, duty or liability which arises under a contract of sale by implication of law may be negatived or varied by express agreement, course of dealing or trade usage, but subject to UCTA; however, if the contract is made before 1 February 1978, it is governed by Paragraph 11 of Schedule 1 to this Act (Sale of Goods Act) which, in turn, modifies the provisions of section 55(5). This modified section 55(5) lists particular matters to which regard shall be had in determining whether it is fair or reasonable, in the case of a consumer sale, to allow reliance on a clause excluding the implied conditions as to correspondence with description, merchantable quality, fitness for a particular purpose and correspondence with sample.

[62] Notably, Lord Bridge of Harwich seemed to envisage that his judgment in this case would have some influence on the issue of reasonableness under UCTA: see [1983] 2 A.C. 803, at 815.

more importantly, evidence showed that it had always been seedmen's practice to negotiate settlement of farmers' claims for damages in excess of the price of the seeds *if they (the seedmen) thought the claims were justified.* The latter factor, that is, largely convinced the House of Lords that the disclaimers were unfair simply because their purveyors themselves regarded them as unfair. With respect to the House of Lords' decision, these considerations are doubtful. If the buyers knew of the terms and fully understood their implications, the agreement is the product of the rational estimation of commercial benefits. There is no reason for compelling a firm to contract with a well-informed party in the fashion not chosen by it. It is, too, not intended by the Law Commission.[63] In addition, industry's incentive may be in jeopardy when any of trade terms which have been in constant use and consented to by all parties is open to be subsequently challenged by one party and struck down by the court.[64] Also, the very fact that seed traders would occasionally compensate farmers for consequential loss beyond their contractual obligation is irrelevant since this practice was purely based on the predilection for maintaining good business, the personal value which gives rise to no case for interference by law.[65]

Finally, the House of Lords found that seedmen could, in the circumstance, insure against the risk of crop failure caused by supplying the wrong variety of seeds

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[63] The Law Commission has clearly addressed that a person who has entered into a contract, even a form contract, which includes the promisor's exclusions of liability may have read and understood fully the implications of the terms but decided to accept them because he considered other terms advantageous to him. In the Law Commission's view, it may be reasonable that he should be bound by those exclusions: see Law. Com. No. 69, para 158.

[64] *Cf.* the opposing opinions on the understanding of a contract term in relation to its reasonableness in *Smith* v. *Eric S. Bush* [1987] 3 W.L.R. 889, per Dillon L.J. at 897 (discussed at p. 188, *infra*) and *Walker* v. *Boyle* [1982] 1 All E.R. 634, per Dillon J. at 644, 645 (discussed at footnote 75, *infra*). *Cf.* also the doctrine of fundamental breach (exclusion clauses can, as a matter of construction, cover a fundamental breach if clearly intended by the parties).

[65] In effect, the House of Lords' consideration on this point was followed by the court in *Rees-Hough Ltd.* v. *Redland Reinforced Plastics Ltd.* (1985) 2 Con L.R. 109. Newey J.'s holding that the limitation of remedies of a jacking-pipe manufacturers to the repair or replacement of the pipes did not pass the test of reasonableness under UCTA was largely founded upon the fact that the manufacturers had not relied on the terms but had normally paid compensation to the buyers (tunnelling contractors): see *ibid.*, at 132. However, it also appeared on the facts of the present case that the manufacturers behaved badly in that they had not referred to the terms during the negotiation of the contract although the buyers were their regular customers.

without materially increasing the price of seeds. Obviously, this relates to the economic efficiency in the sense that costs can be minimised if risk is placed on the party who is in a better position to insure against it. But, with respect to the House of Lords' opinion again, when all parties have reached an agreement with full understanding and the agreement is consequently the outgrowth of their rational judgments, there is no room for applying economic efficiency in the face of the parties' wish.[66] As demonstrated in Chapter 1, if this version of economic efficiency is allowed to be pursued, a thief may anomalously be allowed to take property and simply pay damages equal to its value to the owner.[67]

In *Phillips Products Ltd.* v. *Hyland*,[68] the relevant facts of which have earlier been stated,[69] the Court of Appeal, per Slade L.J., mostly agreed with the approach

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[66] For the courts' attitudes towards the relevance of insurance to the issue of reasonableness, see other cases discussed *infra*. A recent case is, however, of particular interest. It has been held in *The Flamar* (*Flamar Interocean Ltd.* v. *Denmac Ltd.* [1990] 1 Lloyd's Rep. 434 that only the "availability" of insurance and not the "actual insurance position" of the party concerned is to be taken into account. The plaintiffs in this case claimed that clauses in a vessels management agreement, which excluded the Managers' liability for consequences of decisions made honestly and in good faith in the management of the ships and provided further that persons employed on the ships shall be regarded as the ship owners' servants whose act, default or neglect shall not fall under the Managers' responsibility, were unreasonable under UCTA. However, the claim based on UCTA was merely intended to be a concealed instrument to discover the defendants' actual insurance position. Desirous to know the defendants' actual insurance position and aware that UCTA encourages the court's consideration of the insurance aspect to assist its decision on reasonableness, the plaintiffs added the UCTA-related claim to the original claims and subsequently made an application for the discovery of the documents relating to the defendants' actual insurance position. Potter J., refusing such application, held that to consider the actual insurance position of the party concerned would be to impose on him a duty of disclosure in relation to this matter which the law does not impose and which UCTA does not suggest: *ibid.*, at 440.

[67] In fact, prior to *George Mitchell*, the House of Lords, in *Photo Production Ltd.* v. *Securicor Transport Ltd.* [1980] A.C. 827, considered the effect of an exclusion clause in a security contract which provided, *inter alia*, that the security company shall "under no circumstances" be responsible for any injurious act or default by the company's employees unless it could have been foreseen and avoided by the company's exercise of due diligence and, in any event, shall not be responsible for any loss except attributable to the negligence of employees acting within the course of their employment. However, since the contract was made before UCTA came into force (and no issue concerned any statutory provisions resembling those under UCTA), the decision depended solely on the common law. Based on the common law "rule of construction", it was held that the words of the clause were clear enough to absolve Securicor from liability even when its employee, on the facts, deliberately lit a fire which then spread to damage the factory to be guarded under the contract.

[68] [1987] 1 W.L.R. 659 (C.A.).

[69] See p. 160, *supra*.

taken by the court below[70] in determining reasonableness of the clause by which the hire company sought to exclude indirectly its vicarious liability for the negligence of its excavator-driver by stipulating that the driver shall be regarded as employee of the hirer. At first instance, Jones J. set out the following facts in support of his conclusion that the clause in question was unreasonable: (1) the defendants carried on the business of hiring out plant and operators while the plaintiffs, in contrast, were steel stockholders having no occasion to hire plant except on the odd occasions when they had to carry out extensions to their factory; (2) the hire was intended for a very short period and was arranged at such very short notice that the hirer-plaintiffs were unable to study and understand the details of the agreement; (3) the clause in question appeared in the hire company's printed conditions not open for discussion between the parties; (4) any businessman customarily insured against third party claims and did not usually insure against damage caused to his own property by his own employees' negligence, with the result that the plaintiffs would have needed sufficient time and a special and unusual arrangement with an insurer to cover this type of damage; and (5) the hirer-plaintiffs could not select the operator-driver and would not have the knowledge to control the way in which the excavator-driver did the job. Apparently, most of these factors point to procedural flaws. It is noted that much weight was attached to the "adhesion" consideration. The Court of Appeal affirmed that Jones J. at first instance did not err in saying that the agreement was, for the plaintiffs, in a very real sense a 'take it or leave it situation'.[71] (Again, this thesis denies the relevance of

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[70] In this regard, Slade L.J., [1987] 1 W.L.R. 659 at 668, has drawn attention to the approach enunciated by the House of Lords in *George Michell (Chesterhall) Ltd.* v. *Finney Lock Seeds Ltd.* [1983] 2 A.C. 803 at 815-816 that a decision of a court below as to "reasonableness" has much in common with the exercise of a discretion and that the appellate court should consequently treat the original decision with the utmost respect and not interfere with it unless satisfied that it proceeded upon some erroneous principle or was plainly and obviously wrong.

[71] [1987] 1 W.L.R. 659, at 669. *Cf. Green Ltd.* v. *Cade Bros. Farms* [1978] 1 Lloyd's Rep. 602 (the clause limiting the seller's liability to the purchase price of the seed potatoes was held fair and reasonable on the ground, *inter alia*, that it was contained in a standard form of conditions produced by the National Association of Seed Potato Merchants and used for over twenty years so that they evolved as a result both of trade practice and discussions between organisations representing both parties and thus were not conditions imposed by the strong upon the weak). See also *Walker* v. *Boyle* [1982] 1 All E.R. 634, at 645 (where Dillon J. noted that the clause in question which was held unreasonable was contained in the National Conditions and thus was not the product of negotiations

the adhesive feature of a contract to the question of its fairness. Two criteria for determining substantive unfairness can, however, be deduced from the court's considerations. These are the factors (4) and (5) above. A clause excluding liability for a particular loss would be regarded as unreasonable if the purveyor is in a better position to insure against such loss, or if he is in a better position to avoid it.

In the same year, the Court of Appeal, in *Smith* v. *Eric S. Bush*,[72] determined reasonableness of disclaimers in a valuation report prepared by a firm of surveyors which was instructed by a building society to carry out a visual inspection of a house on the security of which an advance was to be made to an intending purchaser (the mortgage applicant) and to make such report which was to be supplied to that purchaser. The disclaimers warned the applicant that the report was not a result of a structural survey (i.e it was made only from a visual inspection of the property), expressly excluded the valuers' responsibility for its inaccuracy and ended with the following words: "The surveyor(s) has/have made this report without any acceptance of responsibility on his/their part to you". The surveyor noticed that the chimney breasts in two of the first floor rooms had been cut away. This fact should have put him on inquiry as to whether that had been done in a way which left the chimneys above adequately supported. But he failed to check this although this task would have involved no more than putting his head and shoulders through the trap door into the roof and would have taken him no more than ten minutes, especially with the aid of the ladder which he then had. Had he checked this, he would have seen at once that the brickwork of the chimneys had been left unsupported by the removal of their breasts. Yet, the report said that the house was readily saleable for owner occupation without any essential repairs.

Certainly, no contract came into being between the firm of surveyors and the mortgagor-buyer since the latter only made a contract with the building society in relation to the mortgage. The action was, therefore, brought against the firm of

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between representative bodies; however, it must be noted that the reason for holding it unreasonable largely lay in the self-evident unfairness, as will be demonstrated below: see footnote 75, *infra*).

[72] [1987] 3 W.L.R. 889.

surveyors in negligence when the chimneys collapsed. Even though UCTA also empowers the courts to look into reasonableness of a disclaimer contained in a *notice* which has no contractual effect, the court's views regarding whether a notice-contained disclaimer is reasonable can also cast light on whether it is perceived of as being reasonable if it is contained in a *contract*. Despite the distinction made under UCTA, by section 11(1) and (3), between the reasonableness test in respect of a contract term and that in respect of a non-contractual notice, both subsections similarly direct the courts to have regard to all the circumstances. The difference lies only in the relevant time at which those circumstances were present and the test should be tested—the time when the contract was made, in the case of a contract term; and the time when the liability arose (i.e when the duty of care arose), in the case of such a notice.[73]

The Court of Appeal held that although the disclaimers in question could be interpreted to cover tortious liability of the firm (covering even the situation where the surveyor did not check apparent, as opposed to hidden, defects with reasonable care, as in the present case), it was not fair or reasonable to allow the firm to rely on them. All judges deciding this case seemed to be in agreement as to the reason for declaring the disclaimers unreasonable. The court was concerned that the firm was instructed to carry out a "visual survey" which entailed the examination of only apparent defects without compelling the discovery of hidden defects, such a defect which was required only of a "structural survey".[74] The circumstances of the case indicated that the defects leading to the collapse of the chimneys were obviously apparent and not of a hidden type at all. When the disclaimers purported to exclude liability even where the surveyor's visual inspection turned out not to have been reasonably careful, the clauses were manifestly unfair. In reality, it would have been more easily perceptible if the court's reasoning regarding reasonableness had simply been couched in terms of an "illusory" obligation. The firm, that is to say, was instructed to carry out a visual

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[73] It is noteworthy that when this case went to the House of Lords, Lords Griffiths regarded the present situation as "not far removed from that of a direct contract between the conveyor and the purchaser: see [1990] 1 A.C. 831, at 859F.

[74] *Ibid.*, per Dillon L.J. at 896, the point on which other judges concurred with his Lordship's opinion.

inspection but, by means of the disclaimers, was at liberty to refrain from doing so. The unfairness of this type is axiomatic or, put in another way, self-evident.[75]

It should be noted that Dillon L.J. said, at the end of his judgment, that the outcome of the case would have been different if the mortgage applicant had himself been a surveyor or a lawyer who could understand the matters. In his words, "I do not think she (the mortgage applicant) would have seen any reason to incur the additional cost of instructing a second surveyor after she had read the copy of Mr.Cannell (the surveyor)'s report".[76] This account, although not explicitly spelled out by UCTA, is in line with this thesis's analysis. Ignorance of implications of a contract term concerned must be shown before such term can be destructible as substantively unfair.[77]

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[75] In reality, self-evident unfairness can also be visualised elsewhere albeit without the courts' explicit mention of it. In *Walker* v. *Boyle* [1982] 1 All E.R. 634, Dillon J. held that it was unfair to allow a vendor of a property, who innocently misrepresented that there were no disputes regarding its boundaries, to rely on a clause in a contract of sale of the property which provided that the purchaser could not annul the sale even where the vendor made misrepresentation or omission in any preliminary answer concerning the property. After the recital of the wording of section 11(1) of UCTA which directs the courts to take account of the circumstances which were or ought reasonably to have been known to the parties when the contract was made, Dillon J., at 644, *immediately and straightforwardly*, regarded the clause as not reasonable. Such an immediate conclusion much augurs for the court's granting that the unfairness of such a clause was so self-evident that it needed no further substantive explanation. By way of comparison, it is noted that before Dillon J., *ibid.*, at 642-644, determined reasonableness of the clause under UCTA, the issue was also considered in the light of equity, in respect of which he said that authorities made it clear that it was astounding if a vendor could, by means of such conditions of sale, force upon a purchaser a defective title even though he knew of the defect and that the Court of Equity would never have enforced a contract under such circumstances. This equitable consideration also rested upon the "self-evidence" approach. For other cases where this approach is found, see *infra*.

[76] [1987] 3 W.L.R. 889, at 897.

[77] A modern, but rather far-fetched, view regarding the understanding of contractual terms is found in *Walker* v. *Boyle* [1982] 1 All E.R. 634, at 644-645 where Dillon J. has said that the mere fact that a lawyer acts for a contracting party cannot vindicate the conclusion that that party fully knows of and understands the contract term, for it is unrealistic of a lawyer to go through the small print of those somewhat lengthy conditions with a tooth-comb every time he is advising a purchaser or to draw the purchaser's attention to every problem which on a careful reading of the conditions might in some circumstance or other conceivably arise. It may be argued that the nature of an advice contract itself imposes on the advisor the obligation to give the advisee detailed advice and that the complication found in the contract concerned should not preclude this duty. In consequence, it is justifiable to equate the knowledge of a lawyer with that of the client and, notably, a firm which deals with this class of consumers tends to repose much reliance on this equation. Allowing a consumer in this setting to invoke the lack of understanding as a ground for undoing contract terms may hamper the industry's incentives. It is more apposite to relegate the consumer's right to a claim against his lawyer for breach of duty of careful and diligent advice.

Smith v. *Eric S. Bush* was subsequently brought to the House of Lords. On this occasion, the House of Lords' decision[78] on reasonableness has spurred particular attention. Lord Templeman, in holding that the disclaimers did not satisfy the reasonableness test, principally stated the following facts rather than spelled out specific indicia of substantive unfairness: the surveyor knew that 90 per cent of purchasers relied on a report; many purchasers could not afford a second valuation; and, finally, the fact that mortgagees such as building societies would appoint careful valuers in their interest induced purchasers to trust the valuer so appointed.[79] Notably, under the citation of these facts, his Lordship was looking at social circumstances. However, with respect, an argument can be raised why a purchaser's inability to afford an independent valuation should establish a justification for the judiciary's interference with contractual terms on which a firm prefer to deal with individuals if those contracting parties have entered into the contract with full understanding of the effects of the terms. This form of intervention is not different from directly compelling the rich to help the poor, the notion which is generally untenable in democratic countries. Assistance to the impoverished should be in any other forms. The state should, for instance, consider the establishment of local valuation offices for the benefit of citizens. It also occurred to his Lordship to give much importance to the disastrous effect on the purchaser if risk was not borne by the firm of surveyors. The purchaser would stand to lose his home and yet remain indebted to the mortgagee if the valuer's report could absolve his liability.[80] This balance of disastrous effects appears a useful criterion for identifying an unfair character of a contract term.[81]

However, the leading judgment was delivered by Lord Griffiths. His Lordship, having pointed out the impossibility of an exhaustive list, considered four matters in

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[78] [1990] 1 A.C. 831 (H.L.).

[79] *Ibid.*, at 852.

[80] *Ibid.*

[81] This criterion was adopted by Baker J. in *St. Albans*, The Times, 11 November 1994 (discussed *infra*) but was inappropriately applied.

order to arrive at his decision on reasonableness.[82] First, the equality of bargaining power between the parties must always be looked at. Secondly, the feasibility of alternative valuation must be taken into account, having regard to cost and time constraints of the purchaser. Lord Griffiths thought that it was not practical for young first-time buyers who are likely to be under considerable financial pressure to afford a second valuation to protect their interest. Next, the degree of complexity and danger of the undertaking must be considered in association with the risk intended to be excluded. In this connection, his Lordship could not see that a simple visual inspection could place any difficult burden such as to justify the exclusion of the relevant liability. Lastly, Lord Griffiths, like Lord Templeman, reckoned with the practical consequences of imposing the risk of loss on either party and thought that the assumption of the loss by the surveyor would be unlikely to cause significant hardship while it would be a financial catastrophe for the purchaser. Indeed, his Lordship was of the impression that although the distribution of the risk on the valuer would result in an increase in the valuation fee to cover insurance, it would be better than allowing the whole risk to fall on the purchaser. Amongst these four factors, the factor involving inequality of bargaining power is subject to the same criticism as one we have addressed elsewhere. The second criterion—financial constraint to a private valuation—is also subject to the same caveat as earlier spelled out in regard to Lord Templeman's judgment. Nonetheless, the two last-mentioned matters, on analysis, typify two useful criteria for the determination of unfairness—necessity for protection and cheaper or easier avoidance of loss. Full discussion of this issue will be postponed to Chapter 6.

Finally, Lord Griffiths found the additional feature, in addition to the foregoing four factors, which rendered the disclaimers in question unreasonable. That is: given that the surveyor is only employed in the first place because the purchaser wishes to buy the house and provides or contributes to the surveyor's fee, "no one has argued that if the purchaser had employed and paid the surveyor himself it would have been reasonable for the surveyor to exclude liability for negligence".[83] This consideration is,

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[82] *Ibid.*, at 858.

[83] [1990] 1 A.C. 831, at 859.

in fact, the perception of "self-evident" unfairness which we have previously alluded to. Therefore, this approach is not unseen even in the House of Lords.

The most recent case, at the appellate level, in which the judicial view on reasonableness apparently rested upon the "self-evident" unfairness of a contract clause is *Stewart Gill Ltd.* v. *Horatio Myer & Co. Ltd.*[84] A clause in a contract for the supply and installation of an overhead conveyor system provided as follows: "The Customer shall not be entitled to withhold payment of any amount due to the Company under the Contract by reason of any payment credit set off counterclaim, allegation of incorrect or defective Goods or for any other reason whatsoever which the Customer may allege excuses him from performing his obligations hereunder". In his speech on the issue of reasonableness, Lord Donaldson MR said: "nothing could *prima facie* be more unreasonable than that the defendants should not be entitled to withhold payment to the plaintiffs of any amount due to the plaintiffs under the contract by reason of 'credit' owing by the plaintiffs to the defendants ... " Likewise, Stuart-Smith L.J. said: "There can be no possible justification for preventing a payment or credit to be set off against the price claimed". Stuart-Smith L.J. went further to look at the width of the clause and thought that it was too wide and had no limit when it prohibited a customer to exercise the right of set-off "for any other reason whatsoever". In his view, the clause, when read as a whole, was tantamount to "a defence based on fraud".[85] Notably, although the court in this case recognised the guidelines set out in Schedule 2 to UCTA as being of general application to the question of reasonableness, the court did not appear to go on to consider them in detail.

A dictum relating to the requirement of reasonableness under UCTA is also found in *R. & B. Customs Brokers Co. Ltd.* v. *United Dominions Trust Ltd.*[86] This case concerned a clause excluding the seller's implied conditions as to quality and

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[84] [1992] 2 All E.R. 257 (C.A.).

[85] *Ibid.*, at 262. It should be noticed that Stuart-Smith L.J. is of the view that the question whether a contract term satisfies the requirement of reasonableness under UCTA has to be determined by considering the term *as a whole* and not merely that part of it relied on by the plaintiff.

[86] [1988] 1 W.L.R. 321.

fitness for a particular purpose which was contained in a contract to sell a second-hand car to a company. This exclusion would have to be shown to be reasonable under UCTA if the buyer in this case dealt as non-consumer. Since the Court of Appeal held that the company-buyer here was dealing as consumer, the exclusion in question was to be declared void at the outset under section 6(2)(a) of UCTA, without need to decide whether it satisfied the requirement of reasonableness. Nonetheless, Dillon L.J. went on to say that had it been necessary to decide on the point (that is, if the company-buyer in this case, *ex hypothesi*, had been dealing in the course of business), the clause would have satisfied the requirement of reasonableness on the ground that the seller had never possessed or seen the car. The car was bought through the third party who owned a showroom and who had a long-standing trading relationship with the defendant-sellers where credit sales were required by buyers. The usual relationship was triangular: the third party sold the car to the sellers who then entered into their standard form of conditional sale agreement with intending buyers.[87] Also, this dictum betokens an efficacious indicator of substantive unfairness—a circumstantial necessity for the protection of interest—which, again, will be fully discussed in Chapter 6.

Indeed, this "necessity for the protection" criterion was, in the following month after *R. & B. Customs Brokers Co. Ltd.* v. *United Dominions Trust Ltd.*, employed by the court of first instance in *Singer Co. (U.K.) Ltd.* v. *Tees and Hartlepool Port Authority*[88] in which a Port Authority, in response to the plaintiffs' claim for compensation for damage caused to their cargoes during the loading operation carried out by the Authority, relied on two general conditions printed on the shipping note. Clause 24 excluded the Authority's responsibility for any damage during the service performed by them except for injury or damage from the "proven negligence" of their servants; and Clause 26 limited the Authority's liability to £800 per tonne of the cargo's gross weight. Steyn J. held both clauses reasonable largely on the ground that the Port Authority was confronted with practical problems (of loading cargoes which were badly packed or created or badly described or marked) which made it justifiable

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[87] *Ibid.*, at 324.

[88] [1988] 2 Lloyd's Rep. 164.

to stipulate for some form of exception and, in respect of the limitation of liability, had the minimal knowledge of the nature of the cargoes and indeed no knowledge of their value at all.[89]

For the sake of completion, the most recent case of *St. Albans City and District Council* v. *International Computer Ltd.*[90] deserves a brief mention. This case concerned a clause by which an international computer company, making a contract with the City Council to install computers with appropriate software to deal with the Council's finances and particularly to process the Community Charge, sought to limit their liability to the contract price or the amount of £100,000 whichever was the lesser as well as to exclude liability for indirect or consequential loss or loss of business profits. The defect in the software resulted in the loss of over £1.5 million sustained by the Council when it produced an initial miscalculation of the population figure for the Council's area. The issue whether software could constitute "goods" under the Sale of Goods Act 1979 is outside this thesis's concern. The central issue here is only one involving the "reasonableness" of the exclusion clause under sections 3 and 11 of UCTA. In holding it unreasonable, Baker J. not only alluded to section 11 and Schedule 2 but also referred to *George Mitchell* and *Smith* v. *Bush* in relation to the insurance standpoint and the consequences of an exclusion clause respectively. Baker J. first pointed out four relevant factors in the instant case: (1) the parties were of unequal bargaining power (and here he believed that although the Council's bargaining power was better than an individual's it was weaker than that of the defendants); (2) the limitation of liability to £100,000 was small in relation to the potential risk and the absolute loss; (3) the defendants were insured and (4) the practical consequences. On analysis, the factors (2) and (4) fell under the same heading: the practical catastrophe

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[89] *Ibid.*, at 170. In addition to this principal ground, Steyn J. observed, *ibid.* at 169, the insurance aspect and seemed to conclude that it was, generally speaking, cheaper for the cargo owner to take "indemnity insurance" than for the port operator to obtain "liability insurance". Moreover, Mr. Justice, *ibid.* at 170, looked into the substance of the exclusion clause and thought that it did not absolutely exclude liability but it merely stipulated for a reversal of the burden of proof of negligence. (This stance, it is of note, is in line with Stuart-Smith L.J. consideration of the "width" of a contract clause in *Stewart Gill Ltd.* v. *Horatio Myer & Co. Ltd.*, which has been discussed above: see p. 191, *supra*.) In other words, when exclusion was limited, it was unlikely to be self-evidently unfair.

[90] The Times, 11 November 1994.

caused by the clause concerned. In the result, Baker J.'s conclusion that the clause in question was unreasonable was focused on the facts that the computer company was well able to insure (and in this case was actually insured) and that if loss was to be borne by the Council it would ultimately be borne by the local population, either by increased taxation or reduced services. Arguably, although the "practical consequence" consideration was apparently derived from *Smith* v. *Bush*, it was applied too widely to be tenable in *St. Albans*.[91]

IV: CONCLUSION

The Unfair Contract Terms Act has already deluded its title when its application is generally limited to exclusion clauses. Even leaving aside this limitation, the Act, in its large part, has not been enacted with an appropriate framework. Most importantly of all, sharp and determinable indicia of an unfair substance of a contract clause have not been explicitly provided. The guidelines for the application of the reasonableness test as set out under the Act are a spurious proxy for the indicators of substantive unfairness whence most of them are in reality indicative of "unfair procedure"—impropriety in the formation process of a contract—rather than "unfair substance" of the clause concerned. Moreover, as far as unfair procedure is concerned, some guidelines are irrelevant and should be excluded from the judicial consideration. However, amongst the procedural improprieties outlined in UCTA guidelines, a praiseworthy aspect can be seen in that consumers' ignorance or the parties' state of knowledge of contract terms is recognised as significant, thereby supplementing the common law doctrines which run counter to the reality in the modern era of trade. This recognition, albeit restricted to exclusion clauses, helps alleviate problems concerning transaction haste and complexity of contract terms which occur pervasively in daily transactions.

Further, a deficiency is found in the fashion in which the Act juxtaposes, in the provided guidelines, factors indicative of procedural improprieties. The Act merely lists

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[91] See also the relevant criticism on this point in Elizabeth Macdonald, "*The Council, the Computer and the Unfair Contract Terms Act 1977*", (1995) 58 M.L.R. 585, at 593.

those factors as guidelines for the determination of unreasonableness but fails to clearly state them as the pre-condition for the examination of the unfair substance of a contract clause. No clear mention is found in UCTA that procedural unfairness must have existed together with substantive unfairness before a clause can be declared unfair or unreasonable, although this stance has been found in cases decided under it. Last, but not least, the legislative framework regarding the distinction between consumers and businessmen runs into confusion when commercially sophisticated businessmen are also protected simply on the ground that the contract has been concluded on a standard form basis or made subject to standard terms of business.

These deficiencies call for revision. However, special legislation is still needed for the protection to apply to other terms beyond the context of exclusion clauses, for a solution to informational asymmetry to be fully achieved and for uncertainty generated by the lack of indicia of substantive unfairness to be alleviated to such an extent as to, at least, prevent an adverse impact on business incentives which would otherwise arise.

CHAPTER 4

AMERICAN DOCTRINE OF UNCONSCIONABILITY: UCC SECTION 2-302

I: INTRODUCTION

The movements towards a general rule empowering the courts to scrutinise unfair contractual terms have over the last few decades remarkably emerged in the United States. The existing supervisory power of the judiciary under equity which has long provided redress against hard bargains has now been supplemented by the statutory "doctrine of unconscionability" now embodied in section 2-302 of the Uniform Commercial Code (hereinafter referred to as "UCC"). This section, however, not only functions as a restatement of the long-established equitable rule but also serves as a device guarding against contractual clauses which, though apparently unfair, can escape the operation of equity. This doctrine, in particular, brings harsh terms contained in standard-form contracts under its scrutiny. It will be seen, however, that this statutory scrutiny is not aimed at rectifying substantive unfairness or unconscionability *per se*.[1] An unconscionable clause can be subject to judicial rewriting or nullification only when it is generated by some procedural defects, which include market imperfections, the modern forms of procedural irregularities which we have expounded in Chapter 1. This chapter examines the American experience with this doctrine in the hope that this empirical study can bring to light appropriate features as well as shortcomings of the contract control pattern which the English legislature may usefully learn and decide to adopt or deny when tailoring or reforming its own general rule.

II: GENERAL PRINCIPLE

Like the English position, American courts have traditionally taken the view that substantive unfairness *per se* is not to be attacked. Economic individualism appears to have been the fundamental postulate in the judicial thinking and freedom of contract has been regarded as part of the common law heritage. All inquiry into

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[1] In this Chapter, the term "substantive unconscionability *per se*" is intended to convey the same connotation as the term "substantive unfairness *per se*" which has been conceptualised in Chapter 1.

"adequacy" is avoided and the Roman law rule of *laesio enormis*, which allowed relief on the ground of inadequacy of price measured by some purely arithmetical test, has never found a place in the law.[2] Without any procedural impropriety (leaving aside the illegality issue), a contract is generally to be enforced. This proposition is reflected in numerous judicial statements:

> "It is normally stated that the parties are forced to make whatever contracts they please so long as there is no fraud or illegality."[3]
>
> "American courts have traditionally taken the view that competent adults may make contracts on their own terms, provided they are neither illegal nor contrary to public policy and that in the absence of fraud, mistake or duress a party who has fairly and voluntarily entered into such a contract is bound thereby, notwithstanding it was unwise or disadvantageous to him."[4]
>
> "People should be entitled to contract on their own terms without the indulgence of paternalism by courts in the alleviation of one side or another from the effects of bad bargain. Also, they should be permitted to enter into contracts that actually may be unreasonable or which may lead to hardship on one side... ."[5]

It is sometimes expressed that the general principle above has been qualified by the courts as they undo contracts or contractual clauses which they find to be "unconscionable". This line of expressions may create the image that courts seek to encroach upon individual exchange by rectifying substantive unfairness or unconscionability *per se*. This interpretation is not to do justice to judicial adjudication. On perusal, the courts generally use "unconscionability in two senses. First, the term is employed to connote "harsh bargains" in equity cases, where the courts have struck down a contract "such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other".[6] It will be

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[2] See James Gordley, "*Inequality in Exchange*", (1981) 69 Cal. L.R. 1587, at 1588, 1592, 1638-1645; Dawson, "*Economic Duress—An Essay in Perspective*" (1947) Mich. L.R. 253, at 277. See also footnote 148 of Chapter 1, *supra*.

[3] *Frostifresh Corporation* v. *Reynoso* (1966) 274 N.Y.S. 2d 757, at 759.

[4] *Wille* v. *Southwestern Bell Telephone Company* (1976) 549 P.2d 903, at 905, citing 18 A.L.R. 3d. 1305, § 2, p. 1307.

[5] *Gas House Inc.* v. *Southern Bell Tel.&Tel. Co.* (1976) 221 S.E.2d 499, at 504, citing *Williston on Contracts* 3rd edn. §1632, which, in turn, derives this statement from *Carlson* v. *Hamilton* (1958) 332 P.2d 989, at 990.

[6] See *infra*.

seen shortly that in most cases the courts, in exercising their equitable jurisdiction, struck down such a contract when there also appeared an abuse of the bargaining process or the advantage-taking of one party's position. Therefore, "unconscionability" in this (equitable) sense is not necessarily related to unconscionability *per se*. The second sense in which "unconscionability" is used involves unconscionability as contained in the UCC § 2-302, which, as mentioned earlier and will be elaborated upon shortly, is not intended to meddle with substantive unfairness *per se* either.[7]

III: UNCONSCIONABILITY IN EQUITY

Bargains which are not enforced in equity are often expressed in the language of "inequitable" or "unconscionable". English cases concerning "unconscionable bargains" appear to have influenced American courts of equity. The fact that American courts tended to use the language expressed by early English equity courts to characterise an "unconscionable bargain" brings this influence to light. In particular, the language of Lord Chancellor Hardwicke in *Chesterfield* v. *Janssen*[8]—"a contract such as no man in his senses and not under delusion would make on the one hand, and as no honest and fair man would accept on the other"—has been adopted by the court in *Hume* v. *United States*[9]. As already seen in Chapter 2, the English doctrine of unconscionability has been developed to set aside an unconscionable bargain only when advantage has been taken of the other party's position or circumstances of weakness.[10] Without this abuse of position, inadequacy *per se* is of no concern of equity and no rescission is allowed on the mere ground of gross disparity alone. We have also pointed out in Chapter 2 that cases in which courts inadvertently spoke of gross inadequacy without explicitly discussing the element of abuse of position were

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[7] For the use of "unconscionbility" in those two senses above, see, for example, *Wille* v. *Southwestern Bell Telephone Company* (1976) 549 P.2d 903, at 905.

[8] (1751) 2 Ves. Sen. 125, 21 E.R. 82.

[9] 132 U.S. 406, 33 L ed 393. For equivalent expressions, see, for example, *Carlton* v. *Hamilton* (1958) 332 P.2d 989, at 991 ("a contract so unconscionable that no decent, fair-minded person would view the ensuing result without being possessed of a profound sense of injustice").

[10] Notably, Lord Hardwicke in *Chesterfield* v. *Janssen* clearly stated that the abuse of the party's position was crucial.

explained by later courts as instances in which the courts presumed "fraud" (constructive fraud, namely, the advantage-taking or abuse of position) from such gross inequivalence.

Although the phrasing characteristic of unconscionability has been borrowed from early English cases, it is not clear-cut whether American courts of conscience have also adopted the rationale concerning the abuse of position and the non-rectification of substantive imbalance *per se*. On the one hand, it is noted by Farnsworth that a bargain is usually declared unconscionable in equity when it is infected with something more than substantive unfairness alone—it is *typically* mixed with an abuse of the bargaining process that does not rise to the level of misrepresentation, duress, or undue influence and, often, it is obtained by taking undue advantage of one's position.[11] Farnsworth also notices that whereas the English equitable doctrine of unconscionable bargains has the effect of setting aside the bargain in question, the exercise of this jurisdiction by American courts is typically limited to the denial of relief of specific performance, without precluding the enforcement of the bargain at law.[12]

On the other hand, there are a considerable number of reported decisions wherein the courts appeared to attack harsh bargains without considering the element of advantage-taking. In this line of cases, the common language used by the court to describe unconscionable bargain is "shock the conscience": a bargain that was so unfair as to shock the conscience of the court would not be enforced in equity. This was obviously adopted from the English case of *Coles* v. *Trecothick*.[13] Although it was said in those cases that such a bargain merely raised a presumption of (constructive) fraud,

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[11] E.A. Farnsworth, *Contracts*, 2nd edn., (Little, Brown and Company, 1990), § 4.27, p. 321.

[12] *Ibid.*, p.p. 322, 323. For equity cases in which specific performance was rejected, see *Marks* v. *Gates* (1907) 154 F. 481, at 483 (the promise sought to be enforced was "so gross as to render the contract unconscionable"); *Kleinberg* v. *Ratette* (1929) 169 N.E. 289 (a purchase of a plot of ground rendered less valuable by the presence of underground water course; the court said "while this court, in the exercise of its equitable power, may not grant recission of the contract, it may stay its hand, and refuse its mandate of specific performance...").

[13] (1804) 9 Ves. Jun. 234, discussed in Chapter 2, *supra*.

scholars[14] have observed that in practice the courts conclusively admitted the bargain as fraud without requiring actual proof of it or allowing rebuttal. Consequently, this was not different from an outright attack, in a disguised form, on mere imbalance or substantive harshness *per se*.[15] Moreover, in many cases, the judicial exercise of this equitable jurisdiction *vis-à-vis* conscience-shocking bargains was not restricted to the denial of specific performance. It was also for the grant of rescission of the bargain in question,[16] although in the original English case of *Coles v. Trecothick* above, this "shocks-the-conscience" notion was employed merely for the refusal of specific performance.

The conflict in the adjudication as regards whether to attack mere substantive inequivalence *per se* may be explicable when one considers the transformation of American law of contracts which has come to light upon Horwitz's work.[17] Horwitz demonstrates the change of judicial role from the insistence upon the substantive fairness of exchange to the acceptance that courts had no such business, and notes that this change was a response of the development of an extensive market economy which erodes notions of objective value and just price, the change which first occurred in

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[14] For example, Dawson, *op. cit.*, (footnote 2, *supra*), at 280-281.

[15] A striking illustration is *Burch* v. *Smith* 65 A.D. 155, 15 Tex. 219, which concerned a suit brought by a widow to set aside a conveyance of an estate for the consideration of $250, wherein the court said that fraud may not be discernible by the direct evidence: "its existence in a given case may be proved, either by intrinsic evidence of unfairness in the transaction itself, or by evidence of facts and circumstances attending it" and thus such unconscionableness or inadequacy such as would shock conscience would "amount in itself to conclusive and decisive evidence of fraud": see *ibid.*, at 155-156. Although extrinsic evidence of fraud was also found in this case, the court set aside this conveyance *mainly* because in the court's view such an inadequacy shocked the conscience and amounted *in itself* to conclusive evidence of fraud. The report of this case was accompanied by a detailed annotation on case law concerning proof of fraud as required by courts of equity.

[16] See, for example, *Burch* v. *Smith*, *supra*; *Butler* v. *Duncan* (1881) 47 Mich. 94; *Mann* v. *Russey* (1898) 101 Tenn. 596, 49 S.W. 835 (suit brought by a widow to set aside a sale of land at the price 6 times its real value); *Johnson* v. *Woodworth* (1909) 119 N.Y.S. 146 (recission of a conveyance of land transferred for a consideration of less than $500); *Sherman* v. *Glick* (1914) 142 P. 606 (action to set aside an exchange of a tract worth $3,000 for a tract worth much less); *Shaffer* v. *Security Trust & Sav. Bank* (1935) 41 P.2d 948 (action brought by the purchaser's executor for recission of a contract for sale of a lot never worth more than $2,500 for $7,000); *Jackson* v. *Seymour* (1952) 71 S.E.2d 181 (action for recission of deed to convey a tract of land for the price of $250, one-tenth the value of timber found thereon).

[17] Morton Horwitz, *The Transformation of American Law* 1780-1860, (Harvard University Press, 1977).

England and was then warmly received in America.[18] In view of this transformation, it can be concluded that from the nineteenth century onwards the typical formulation of equitable relief against unconscionable bargains has been that the courts, influenced by economic thoughts, will not grant relief unless such a bargain is infected with an element of advantage-taking. Unconscionability *per se* does not suffice.

Although it is far from clear whether the equitable remedy for an unconscionable contract is restricted to the refusal to grant specific performance or also extended to rescission, such cases in which contracts were rescinded on the ground of unconscionability in equity can be found more frequently than on an exceptional basis. In addition, on many occasions where damages are claimed, the courts have been seen invoking unconscionability as a ground to mitigate or reduce damages to what the plaintiff is equitably entitled to. This was even the case in *Hume* v. *United States*.[19] By the same token, in an action to recover an unconscionable price, the courts tend to have allowed only the market value of the goods. All these are indicative of the decline in the restriction of unconscionability claims in equity to the refusal of specific performance.

IV: UCC § 2-302: THE STATUTORY DOCTRINE OF UNCONSCIONABILITY

1. Overview

The equitable doctrine of unconscionability is not the last legal development in the light of the attempt to provide relief against unconscionable bargains. Legislative concerns in contractual fairness have given rise to the expansion of equity. The equitable doctrine of unconscionability has then been made statutory when § 2-302 of the UCC was enacted. Although it was, to a large extent, inspired by equity, this

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[18] *Ibid.*, pp. 160-180, reviewed by Charles J. McClain, Jr. in "*Legal Change and Class Interests: A Review Essay on Morton Horwitz's The Transformation of American Law*", (1980) Cal. L.R. 383, at 388.

[19] (1889) 132 U.S. 406, 33 L ed 393. The court, per Fuller C.J., heavily relied upon *James* v. *Morgan* Ventris 267 and *Thornborough* v. *Whitacre* 6 Mod. 305 in declaring such a law. See also *Scolt* v. *United States* (1870) 79 U.S. 433, at 445 where the court enunciated: "If the contract be unconscionable, a court of law will give to the party who sues for its breach damages only such as he is equitably entitled to."

statutory provision is of much broader application than its precursor since, as will be elaborated below, apart from taking up the room in equity, it is also effective in eviscerating unfairness of a contract or its clause which is unremedied by the equitable doctrine. This is particularly the case when a party enters into a contract without full knowledge of the implications of unfair terms and the element of advantage-taking is not obvious, which is a common incident in the era of standard-form contracts.

Section 2-302 provides as follows:

> "(1) If the court as a matter of laws finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.
>
> (2) When it is claimed or appears to the court that the contract or any clause thereof may be unconscionable the parties shall be afforded a reasonable opportunity to present evidence as to its commercial setting, purpose, and effect to aid the court in making the determination."

Although this section is part of Article 2 which concerns sales, American courts tend to have applied it to other agreements beyond sales, either by means of analogy[20] or by enunciating that this statutory doctrine is also the general doctrine of the common law.[21] As a result, this unconscionability provision has a general application. In particular, in recent cases, it has much been invoked in leases. In fact, the framers' intention to bring contracts in general within the ambit of this provision is reflected in the description by Professor Karl Llewellyn, who is credited with its initial draft, that it

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[20] See, for example, *Weaver* v. *American Oil Company* (1971) 276 N.E.2d 144 at 148; *Wilson* v. *World Omni Leasing, Inc.* (1989) 8 UCC Rep Serv 2d 628, at 630 (applicability, by analogy, to leases). Some courts applied § 2-302 to leases or other contracts without stating the reason of its applicability: see, for example, *Bank of Indiana, NAT. Ass'n* v. *Holyfield* (1979) 476 F. Supp 104 (lease); *United Van Lines* v. *Hertz Penske Truck Leasing, Inc.* (1989) 710 F. Supp 283, 8 UCC Rep Serv 2d 1024 (lease); *Gillman* v. *Chase Manhattan Bank* (1988) 7 UCC Rep Serv 2d 945 (security agreement). These courts may have thought that the analogy approach was too widely recognised to need a mention. In some cases involving leases, the courts applied § 2-302 because in the courts' view the transaction which was cast in the form of a lease "assumed the true model of a sale" or "tended to the identical economic result to a sale": see *Industralease Automated & Scientific Equipment Corp.* v. *R.M.E. Enterprises, Inc.* (1977) 396 N.Y.S. 2d 427, at 430; *United States Leasing Corp.* v. *Franklin Plaza Apartments, Inc.* (1971) 319 N.Y.S 2d 531, at 535. This type of reasoning, however, also has the element of analogy.

[21] See, for example, *Williams* v. *Walker-Thomas Furniture Company* (1965) 350 F.2d 445, at 448.

is "perhaps the most valuable section in the entire Code".[22] This implicit intention was finally responded when the legislature enacted the Restatement (Second) of Contracts. Section § 1-208 thereof,[23] which is of general application, contains the doctrine of unconscionability phrased in the language much similar, both in pattern and substance, to UCC § 2-302. Moreover, it appears from the Preliminary Report of the Study Group, appointed in 1988 (10 years after the UCC was enacted) by the Permanent Editorial Board of the UCC to examine whether Article 2 of the Code should be revised, that a recommendation was made that although the text of § 2-302 needed no revision the Comment accompanying the section should be amended to clarify the scope of the section and that this section should be moved from Article 2 (Sales) to Article 1 (General Provisions) so as to be applicable to all contracts under the UCC.[24] Also, in the State of California, the identical language in UCC § 2-302 was enacted as section 1670.5 of the Civil Code which is placed under the "Unlawful Contracts" heading of Division 3, Part 2, Title 4 of this Code and applies to all contracts.[25] All this indicates increasing attempts to make the unconscionability provision applicable across the board and it is submitted that it has become part of general contract law. Now, the doctrine as embodied in § 2-302 has much been described in general works on contract law as if it were a general rule of the law of contract as a whole, rather than of the law of sales only. Therefore, analyses to be made in this Chapter of this

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[22] New York Law Revision Commission, *Hearings on the Uniform Commercial Code*, (1954), p. 121, cited in Farnsworth, *Contracts*, (footnote 11, *supra*), § 4.28, p. 323.

In fact, Llewellyn's intention as such had appeared even earlier. At the meeting on May 9, 1944, he, when asked why the doctrine should not be applicable to *all* contracts, replied: "The only justification that we can give for its being here and not elsewhere is that as yet we have not codified the whole commercial law but only this chapter. As the policies apparently involved here go, it certainly will be extended so much as is reasonably proper in the later portions of the Code": see (1944) 21 *The American Law Institute Proceedings*, p. 115.

[23]This section read:

> § 208 Unconscionable Contract or Term
> "If a contract or term thereof is unconscionable at the time the contract is made a court may refuse to enforce the contract, or may enforce the remainder of the contract without the unconscionable term, or may so limit the application of any unconscionable term as to avoid any unconscionable result."

[24]The American Law Institute, *PEB Study Group, Uniform Commercial Code Article 2, Preliminary Report*, (1990), p. 79.

[25]For cases decided under this provision of the Civil Code, see, for example, *A & M Produce Co.* v. *FMC Corp.* (1982) 186 Cal.Rptr. 114, at 121.

unconscionability doctrine under § 2-302 will be on the assumption that it is of general application. These analyses can equally apply to § 1-208 of the Restatement (Second) of Contract, given that it is, in principle and substance, merely a restatement of UCC § 2-302 as far as the unconscionability notion is concerned.

2. Drafting History

2.1 Initial Concern with "Form" Contracts or Clauses

There appeared various drafts[26] of the unconscionability section before it has culminated in § 2-302. The developments in the drafting of this provision can be much traced from forewords or letters of transmittal of each draft. Early drafts were directed only at "form contracts" or "form clauses". Draftsmen did not intend to object outright to the use of forms but attempted to ensure that such a contract was to be genuinely consented to by the parties. The 1941 draft clearly stated that clauses contained in a form contract would be, although at variance with the law, insulated from judicial review provided that they were the deliberate desire or action of the parties.[27] The principal concern of the draftsmen was with the fact that the deliberate desire or genuine consent might be lacking when the parties entered into form contracts without "due knowledge". Indeed, it was gradually perceived that the absence of due knowledge could be as much prompted by failure to read as by failure to understand the contract or clauses concerned.

2.2 Failure to Read and Failure to Understand Clauses in "Form" Contracts

The next unconscionability provision came out as section 24 of the 1943 draft with its direct title **"Form Clauses, Conscionable And Unconscionable"**. This

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[26]Although all drafts were initially treated as confidential at the time of drafting, most of them are now released for public consultation and this thesis has examined all the available drafts. The only two drafts which are unfortunately inaccessible to this thesis's study are the 1941 and 1943 drafts, so that analyses of these drafts rely on Leff's valuable study: "*Unconscionability and the Code—The Emperor's New Clause*", (1967) 115 U. of PA L.R. 485.

[27] 1941 Draft §§ 1-C (1) (b) and 1-C (1) (e) and Comment A (3) thereto, quoted in Leff, *ibid.*, at 489, 490.

obviously indicated the draftsmen's initial concern with form contracts. This section provided:

> "(1) A party who signs or accepts a writing evidencing a contract for sale which contains or incorporates one or more form clauses presented by the other party is bound by them unless the writing when read in its entirety including the form clauses is an unconscionable contract *and he has not in fact read the form clauses before contracting, except that a merchant who signs and returns such a writing after having had a reasonable time to read it is bound by it.*" (Italics added.)

It is clear from the wording of this draft that it was discerned that the accession, on the part of the disadvantaged party, to unconscionable clauses in a "form" contract was engendered by his failure to read them. Apparently, the issue of inability to understand the contract eluded the draftsmen's concern. Even if this ineptness can be left aside at this stage, incongruity is noticeable from the draftsmen's treatment of the "failure to read" problem. As discussed in Chapter 1, a contracting party should be allowed to invoke failure to read particular contract terms as a ground for judicial review of the fairness in their substance only when he did not have a practical chance to read them at the time the contract was made. The 1943 draft, however, gave effect to this only in respect of merchants. For non-merchant parties, mere failure to read without more sufficed. The next draft, the February 1944 draft,[28] was also puzzling. While the section still permitted merchants to plead unavailability of a reasonable time to read, the element of "failure to read" was crossed out from the section in respect of non-merchant parties.

However, two and a half months later, another draft[29] emerged and totally eliminated from the section the wording relating to the lack of a reasonable time to read, even in respect of merchants. Indeed, this was a laudable development. The removal of the "failure to read" qualification, coupled with the fact that no mention was made of any specific cause of unconscionability, most possibly insinuated that the

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[28] This draft was labelled as "Council Draft No. 1" since it was the first draft submitted to the Council of the American Law Institute for discussion at the meeting held during February 22-25, 1944.

[29] This draft appeared on April 27, 1944. It was the draft which the Council submitted to the American Institute for consideration at the annual meeting in May 1944 and was labelled "Proposed Final draft No.1".

draftsmen intended to have the unconscionability provision embrace pervasive causes including the inability to comprehend contract clauses.

2.3 Extension of Unconscionability to Non-Form Contracts

In 1948, the text[30] of the unconscionability provision made it clear, by its title[31] and its subsection 2, that unconscionability was not limited to form contracts or form clauses. The identical text was contained in the 1949 draft, which was for the first time renumbered as section 2-302. Despite its intended application to form and non-form contracts alike, it was recognised that unconscionable clauses would, in most cases, arise in the context of form contracts. Thus, Comment 3 to the said section 2-302 suggested that this provision was intended to deal specially with the common situation where, in the words of the Comment, "the contents of the questionable clause were never actually discussed or bargained out by the parties and as a result the clause was included in the agreement *without one party's attention ever having been directed specifically to it*" (italics added). Admittedly, this concentrated on a party's "knowledge" of the clause concerned; and, again, want of knowledge contemplated by the Comment was not restricted to "failure to read" but also included inability to understand contract clauses. This position has been retained in official Comments accompanying all subsequent versions, including the current version, of the unconscionability section when the locution "unfair surprise" has been employed to subsume factors affecting the knowledge of the clause concerned.[32] Also, the application of the unconscionability provision to form and non-form contract alike is the approach taken in all subsequent versions. It is submitted that this is the correct

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[30] The text read as follows:

> "(1) If the court finds the contract to be unconscionable, it may refuse to enforce the contract or strike any unconscionable clauses and enforce the rest of the contract or substitute for the stricken clause such provision as would be implied under this Act if the stricken clause had never existed.
>
> (2) A contract not unconscionable in its entirety but containing an unconscionable clause, *whether a form clause or not*, may be enforced with any such clause stricken." (Italics added)

[31] The title was stated as **"Unconscionable Contract or Clause"**, not as **"Form Clauses, Conscionable and Unconscionable"** as in the two previous drafts of 1944.

[32] See the extracted passage at p. 206 and the discussion at p. 211, *infra*.

approach, given that although unconscionable terms and the problem of ignorance relating to contractual terms are most likely to occur in standard-form contracts, they can be found in written contracts which are not form-contracts as well.

3. Significance of Unconscionability under § 2-302

3.1 General: Relevance of Contracting Procedure—Judicial Scrutiny Not Directed at Substantive Unconscionability *Per Se*

The unconscionability doctrine under § 2-302 is intended to give the courts the direct power to scrutinise contract clauses candidly, not by way of such covert tools as used to be employed by the pre-Code courts in order to achieve a fair result. This is reflected in Comment 1 to this section:

> "This section is intended to make it possible for the courts to police explicitly against the contracts or clauses which they find to be unconscionable. In the past, such policing has been accomplished by the adverse construction of language, by manipulation of the rules of offer and acceptance or by determinations that the clause is contrary to public policy or to the dominant purpose of the contract. This section is intended to allow the court to pass directly on the unconscionability of the contract or particular clause therein and to make a conclusion of law as to its unconscionability."

Further reading of the said Comment also suggests that this statutory doctrine is not aimed at rectifying substantive unconscionability *per se*. The harshness of a contract clause must be occasioned by some procedural defects. A marriage of procedural and substantive unconscionability is required for a clause to be subject to the judicial rewriting. The draftsmen seemed to be well aware that in the absence of procedural irregularities the substantive result of a contract is the product of rational judgment and maximisation of utility of all parties. Although one party could possess superior bargaining power, mere inequality of bargaining power without more provides no ground for undoing the contract or its clause. A party of a weaker bargaining position who has entered into the contract on the terms, fixed by the stronger party, with full awareness of their implications and without compulsion, fraud or advantage-taking exerted by the latter is simply regarded as having achieved an increase in his utility, otherwise the contract would not have been made. In this regard, the Comment further states:

> "The basic test is whether, in the light of the general commercial needs of the particular trade or case, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract. ..... The principle is one of the prevention of oppression and unfair surprise (cf. Campbell Soup Co. v. Wentz, 172 F.2d 80, 3rd cir. 1948) and *not of disturbance of allocation of risk because of superior bargaining power*." (Italics added)

Despite the clarity, extracted from the Comment, as regards the non-interference with substantive unconscionability *per se*, something in the Comment may inadvertently attract the contrary argument. This is the ten cases[33] which are included in the Comment and therein stated as illustrating the underlying basis of the section. In almost all of these ten cases, no defects in the contract-procuring procedure were particularly found. As Leff has correctly remarked,[34] none of these cases involved presumptive incompetents. Almost all of these cases involved pre-prepared form contracts and the only case in which procedural defects were pleaded and formed the ground of the court declaring the clause in question as "so manifestly unreasonable" is *New Prague Flouring Mill Co.* v. *G.A. Spears*.[35] In other cases, no issue of procedural wrong was raised and, indeed, many cases involved contracts between merchants. Given that the Comment states these ten cases as underlying the basis of § 2-302, it might be argued that the underlying principle of the unconscionability doctrine under this section is the correction of substantive unconscionability *per se*. However, this appears to be the wrong conviction, for it obviously runs against the clearly stated

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[33] *Kansas City Wholesale Grocery Co.* v. *Weber Packing Corporation* (1937) 93 Utah 414, 73 P.2d 1272; *Hardy* v. *General Motors Acceptance Corporation* (1928) 38 Ga. App. 463, 144 S.E. 327; *Andrews Bros. Ltd.* v. *Singer & Co. Ltd.* [1934] 1 K.B. 17; *New Prague Flouring Mill Co.* v. *G.A. Spears* (1922) 194 Iowa 417, 189 N.W. 815; *Kansas Flour Mills Co.* v. *Dirks* (1917) 100 Kan. 376, 164 P. 273; *Green* v. *Arcos, Ltd.* (1931) 47 T.L.R. 336; *Meyer* v. *Packard Cleveland Motor Co.* (1922) 106 Ohio St. 328, 140 N.E. 118; *F.C. Austin Co.* v. *J.H Tillman Co.* (1922) 104 Or. 541, 209 P. 131; *Bekkevold* v. *Potts* (1927) 173 Minn. 87, 216 N.W. 790, 59 A.L.R. 1164; *Robert A. Munroe & Co.* v. *Meyer* [1930] 2 K.B. 312.

[34] *Op. cit.*, (footnote 26, *supra*), at 502.

[35] (1922) 189 N.W. 815. In this case, it was found, in addition to misrepresentation, that the clause was in fine print and not read or called to the defendant's attention: see *ibid.*, at 820, 821, 824. In delivering the judgment, the court appeared to be also concerned with the lack of understanding caused by linguistic complexity of the contract. In Weaver J.'s words, "If it be a contract it is like the Apostle's conception of human frame, "fearfully and wonderfully made", and one upon the construction and effect of which a component and experienced lawyer may spend days of careful study without exhausting its possibilities": *ibid.*, at 824.

rationale of the section: that the principle is one of the prevention of oppression and unfair surprise and not of disturbance of allocation of risks because of superior bargaining power.

In fact, even when § 2-302 is perceived of as allowing judicial review of an unconscionable contract or clause only when the combination of procedural and substantive unconscionability is found, this perception does not necessarily destroy the significance of the ten cases in "underlying the basis of the section". Despite some commentary that the official-comment cases are not quite on point, they can be discerned as being on point at least in two respects. First, they illustrate two common instances in which harsh clauses have emerged: warranty disclaiming and remedy limitation instances, given that all of these ten cases fundamentally concerned either disclaimers or limitations of remedies. Based on this reality, their inclusion in the official comment may not be squared with the implication that no procedural defect is required as a pre-condition for judicial inquiry into the fairness in the substance of the contract clause concerned. Secondly, they provide illustrations of "covert tools", by which the courts tackled harshness of the clause concerned, and suggest that section § 2-302 is necessary to empower the courts to police unreasonable clauses openly rather than covertly.[36] In at least 5 of these cases, the courts attempted to eviscerate a harsh result of the clause in question not by declaring it unconscionable but by way of construction of the language of the clause.[37] Thus, the reference by the official

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[36] Leff seems to have noticed this role played by these official-comment cases, although without much elaboration: see, *op. cit.*, (footnote 26, *supra*), at 526-527.

[37] See *Andrews Bros. Ltd.* v. *Singer & Co. Ltd.*; *F.C. Austin Co.* v. *J.H. Tillman Co.*; *Meyer* v. *Packard Cleveland Motor Co.*; *Bekkevold* v. *Potts*; *Hardy* v. *General Motors Acceptance Corporation*. A striking illustration is *Andrews Bros. Ltd.* v. *Singer & Co. Ltd.*, which is an English case inserted in the Comment. There, the car sellers disclaimed their warranties by the language "all conditions, warranties and liabilities implied by statute, common law or otherwise are excluded." Scrutton L.J., in delivering judgment, referred to *Willis, Son & Wells* v. *Pratt & Haynes* [1910] 2 K.B. 1003, [1911] A.C. 394 in which the court held that the clause "Seller give no *warranty*, express or implied as to growth, description or any other matters" did not cover a *condition* and that the requirement that the goods should comply with the description was not a warranty but a *condition*, with the result that the disclaimer did not exonerate the seller from breach of this condition. Scrutton L.J. noted that the sellers in *Andrews Bros* were, in using both terms—"conditions" and "warranties"—probably alarmed by the decision in *Willis* v. *Pratt*. Nevertheless, his Lordship still found a way to construe the disclaimer to avoid an unfair result. When the disclaimer literally referred only to *implied* conditions and warranties, his Lordship held that the description in the contract of the car as being a "new" car was an *express* condition even though the Sale of Goods Act 1893 called it

comment to these cases may have been intended to convey the preference of an open tool over covert tools without indeed signifying the notion of striking contract terms independently of procedural unconscionability.

The unconscionability doctrine under § 2-302 operates to police unfairness only at the time the contract was made.[38] It is submitted that this is a correct account of policing since if a contract was initially fair but subsequently rendered unjust as a result of some circumstance after its execution, the matter should be governed by a separate rule of law: the law relating to an adjustment of a contract due to a subsequent alteration of circumstances. If the law in this area is inadequate, its development should be made independently of the doctrine of unconscionability. It is noted that the concept of judging fairness of a bargain as of the time of its execution is not new. It has long been the position in equity, as in *Tuckwiller* v. *Tuckwiller*[39] wherein it was held that a promise made by a seventy three-year-old woman to devise a farm worth $34,000 in return for a promise of lifetime care was fair even if the woman died only a few weeks after the agreement (thereby rendering the consideration on the part of the promisee grossly inadequate), for the incident after the agreement was immaterial.

3.2 Procedural Prong of Unconscionability

As mentioned earlier, equity has played a pivotal role in safeguarding against an abuse of the bargaining process or unconscientious means by which to secure a contract. Although § 2-302 received an inspiration from unconscionability in equity, the procedural prong of unconscionability under this section is extensive, embracing

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an "implied" condition. Likewise, in *Hardy* v. *General Motors Acceptance Corporation* where the seller stipulated in the contract that "no warranties have been made by the seller unless indorsed hereon in writing", the court, having regard to the word "made", construed that the disclaimer merely referred to expressed verbal warranties which might have been made by the seller's agents, not to the statutory implied warranties that the goods were merchantable and reasonably suited to the uses intended, which, in the court's words, "do not have to be "made"... but, if not excluded by the contract, are deemed to be a part thereof as a matter of law".

[38] This was not inserted into the section until the 1957 Official Edition. The insertion was recommended by the Editorial Board after further intensive study of the Code since its promulgation in 1952: see American Law Institute, Supplement No.1 to the 1952 Official Draft of Text and Comments of the UCC, January 1955; American Law Institute, 1956 Recommendations of the Editorial Board for the UCC; American Law Institute, 1957 Official Edition.

[39] (1967) 413 S.W.2d 274.

both procedural defects under equity and new forms of procedural flaws prevalent in new market conditions. As seen from the Official Comment,[40] procedural unconscionability under § 2-302 is embodied in the language of "unfair surprise" and "oppression".

3.2.1 "Unfair Surprise"

The coherence of the "surprise" locution lies in the knowledge of the contract or clause concerned. This component plays a tremendously important role in exorcising unfair terms entered into without the aggrieved party's full awareness, a commonplace incident in the particular, but not exclusive, context of standard-form contracts. The concern which this unconscionability section has in a contracting party's knowledge is far-reaching in that the section brings under its protective regime all instances involving the lack of knowledge about contractual terms: inconspicuousness, lack of reasonable opportunity to ascertain the terms, or incomprehensibility. The accession to harsh clauses out of one or more of these forms of ignorance will result in an unfair surprise on the part of the aggrieved party once he is aware of the unfair consequences.

3.2.1.1 Inconspicuousness

Inconspicuous clauses are a commonplace inception of surprise especially in the context of standardised contracts. In comparison with the English counterpart, American law is more concerned with this problem. Apart from the instance of clauses hidden in a mass of fine print or in an unnoticeable place, conspicuousness of terms printed on the reverse side of a document is peculiarly questionable if the front side makes no reference to them or the reference itself, if any, is in small print. The same analysis applies to the case where additional terms are in a separate document.[41]

It is noted that in his work *The Common Law Tradition*, Llewellyn, the founder-father of § 2-302, is particularly concerned with the fine print problem. His principal trepidation is concentrated on the so-called "boiler-plate" clauses (by which

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[40] See the extracted passage at p. 207, *supra*.

[41] John A. Spanogle, "*Analyzing Unconscionability Problems*" (1969) 117 U. of PA. L.R. 931.

he means pre-prepared clauses printed on the form) which one party enters into mostly without reading the fine print.[42] Llewellyn addresses: "free contract presupposes free bargain; and where bargaining is absent in fact, the conditions and clauses to be read into a bargain are not those which happen to be printed on the unread paper, but are those which a sane man might reasonably expect to find on that paper."[43] Indeed, this expression bears relevance not only to the instance of inconspicuousness but to the contexts of lack of reasonable opportunity to read and inability to understand contract terms as well. However, in this work, Llewellyn appears to emphasise the "fine print" issue. In this regard, Llewellyn finds it "queer" that while the courts happened to police contract terms in transactions which occurred without fine print, those agreements which involved fine print had not much received judicial attention.[44]

Since the promulgation of the UCC, inconspicuousness, in particular in the form of fine print, has often been found as a crucial component of procedural unconscionability in cases decided under § 2-302, albeit in most cases it may have coexisted with other factors indicative of procedural flaws. It is also notable that in cases wherein the courts stated criteria for assessing procedural unconscionability, fine print or inconspicuousness was almost always included in such a statement.[45]

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[42] Llewellyn, *The Common Law Tradition*, (Little, Brown and Company, 1960), p. 362.

[43] *Ibid.*, p. 367. Llewellyn also concedes that any boiler-plate contract results in two contracts: the dickered deal and the collateral one of supplementary boiler-plate. Based on this, he asserts that there is an actual assent only to dickered terms; other terms can be assented to (blanket assent, not a specific assent) only when they are not unreasonable or indecent and do not alter or eviscerate the reasonable meaning of the dickered terms: see *ibid.*, p. 370, 371.

[44] *Ibid.*, p. 370.

[45] See, for example, *Williams* v. *Walker-Thomas Furniture Company* (1965) 350 F.2d 445; *Unico* v. *Owen* (1967) 232 A.2d 405, at 407 (waiver-of-defence clause in fine print and not explained to the other party); *Schroeder and Micske* v. *Bartell Grug Co.* (1979) 593 P.2d 1308, 26 UCC Rep Serv cited in *Veeder* v. *NC Machinery Co.* (1989) 720 F. Supp 847, 10 UCC Rep Serv 2d 841, at 844 ("the court must examine all the circumstances surrounding the transaction, including conspicuousness of the clause... ."); *Construction Associates, Inc.* v. *Fargo Water Equipment Co.* (1989) 446 N.W.2d 237, 10 UCC Rep Serv 2d 821, at 827 ("replacement" remedy-limitation clause contained in the installation guide not furnished to the party until after the formalisation of the sale contract; the court said: "To be part of the bargain, a provision...must, unless incorporated into the contract through prior course of dealings or trade usage, have been bargained for, brought to the purchaser's attention or be conspicuous..."); *United Van Lines* v. *Hertz Penske Truck Leasing, Inc.* (1989) 710 F. Supp 283, 8 UCC Rep Serv 2d 1024, at 1031 (the court referred to and employed the four criteria set forth in *Schroeder* v. *Fageol Motors* (1975) 554 P.2d 20, 18 UCC Rep Serv 584: (1) whether each party had a

In reality, the recognition of inconspicuousness of a contract clause as a procedural impropriety has long been the position of American common law even before the UCC. Inconspicuous clauses shaped in fine print or located in a place beyond sight were frequently held by the pre-Code courts as not incorporated into the contract[46] and, unlike the English doctrine of "reasonable notice",[47] this rule applies to signed and unsigned documents alike. Therefore, the inclusion of "inconspicuousness" cases within the rubric of procedural unconscionability under § 2-302 is a restatement of the existing common law. However, a difference may remain. If inconspicuousness is invoked under the pre-Code common law, the inconspicuous clause is outright regarded as not being an integral part of a contract, with the immediate consequence

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reasonable opportunity to understand the terms of the contract, (2) whether the important terms were hidden in a maze of fine print, (3) the prior course of dealings between the parties and (4) the usage of trade); *Dale R. Horning Co., Inc.* v. *Falconer Glass Industries, Inc.* (1990) 11 UCC Rep Serv 2d 536 (limitation of consequential damages in fine print on the reverse side of the manufacturer's standard form confirming the telephone order); *Earl Brace &Sons* v. *Ciba-Geigy Corp.* (1989) 708 F. Supp 708, 8 UCC Rep Serv 2d 690 (a limitation of consequential damages provision held conspicuous and therefore operational when contained in an instructional booklet attached to the container of a herbicide sold, printed in bold type just after the table of contents and directions for use).

[46] In *Verner* v. *Sweitzer* (1858) 32 Pa. 208, the court, in considering a common carrier's limitation of liability clauses printed on a baggage, addressed: "it has been adjudicated that proof of general notice of limitation of liability must be such as amount to actual notice, or shown to have been so conspicuous, that the party sought to be affected by it could not have failed to discover it without gross negligence ...". In *Cutler Corp.* v. *Latshaw* (1953) 97 A.2d 234 which concerned a contract for the repair of the premises between a contractor and the owner, a "warranty of attorney" (a clause by which the signer deprived himself of every defence and delay of execution and waived benefit of exemption laws) was held inconspicuous and not incorporated into the contract when written in very small type verbiage on the reverse side of the contract, with the reference on the face side. Notably, although the court (per Musmanno J.) said, at 237, "The reference on the face side of the contract to the "conditions" on the reverse side...can hardly be accepted in a court of law...", the court did not intend to utter the absolute disapproval of incorporation by reference. The court seemed merely to ensure the conspicuousness of the clause referred to. It was felt by Musmanno J. that the word "conditions", which was embraced by the reference on the front side, "can not be used to mean surrender of fundamental personal and property absolutes *unless the word appears within a setting which warns of the potency of the capitulation being made*": *ibid.*, at 236 (italics added). On the facts, it was found that the clauses on the reverse side was in small print. (In addition, the physical characteristics of the five-page document indicated that the parties intended not to make the reverse sides any part of the contract. Although the reverse sides carried the word "Specifications" with the word "Continued" in parenthesis (thereby implying the continued enumeration of specifications set out in the front sides), they were never utilised for such purpose.) Indeed, the court referred to three earlier cases in which inconspicuousness was the basis of the judgment on the issue of the incorporation of contract terms. In the first two cases, *Summers* v. *Hibbard* (1894) 38 N.E. 899 and *Sturtevant Co.* v. *Fireproof Film Co.* (1915) 110 N.E. 440, the provision printed on or at the bottom of a letter-head not referred to in the body of the letter (and, in the latter case, in small print) was held not forming part of the body since it was not easily seen.

[47] See Chapter 1, *supra*.

that the court need not go further to assess its substantive fairness. On the contrary, where such a clause is to be decided under § 2-302, it can be removed or amended by the court only when it produces some unfairness in the substantive result, for a finding of unconscionability under this section requires both procedural and substantive unconscionability.[48]

3.2.1.2 Lack of Reasonable Opportunity to Read Contract Terms

The American legislature has been aware that mere conspicuousness may not necessarily ensure a contracting party's knowledge of contract terms since notwithstanding that a term is well conspicuous, a party may not have a reasonable opportunity to read or study it and it is thus of no sense to presume consent in this scenario.[49] As thoroughly discussed in Chapter 1, this problem surrounds the hasty nature of transactions in modern markets. The party who entered into the contract in haste is likely to be unfairly surprised once he has an opportunity to read the terms and becomes aware of their unfavourable effects. It is notable that American common law and equity, like the English counterpart, has no concern in this problem. It follows therefore that the statutory catchment of this contractual situation by reference to "unfair surprise" is a novelty in the legal history. Another thing should perhaps be noted. As we have discussed in Chapter 1, the existence of transaction haste in modern markets is not attributable to traders who deal with general customers. Thus,

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[48] It is noted that even after the promulgation of the UCC, courts in some cases, when unconscionability under § 2-302 was not alleged or pleaded, still struck down a contract clause on the ground that such clause was not conspicuous. For example, in *Drans* v. *Providence College* (1978) 383 A.2d 1033, a term, printed in the faculty manual, which set the mandatory retirement age of members of the faculty at 65 years was held not incorporated into the employment contract, by which the plaintiff-professor was granted lifetime tenure, when the contract made no reference to such manual. (Although the court in this case also held that the college had the power and authority to institute unilaterally a reasonable mandatory retirement policy, this power was not derived from the contract but from the public policy based on the principle that the function of tenure is the preservation of academic freedom and protection of job security and, thus, as long as the retirement plan is adopted in good faith and the age chosen is reasonable, the essential functions of tenure will not be jeopardised.) Also, in *Tassan* v. *United Development Co.* (1980) 410 N.E.2d 902, a disclaimer of liability for breach of an implied warranty of habitability with respect to a sale of new homes was held ineffective when located on the back of the standard form amongst other clauses in the same size and small print with no explanation of the consequences of the disclaimer.

[49] It should be recalled that the 1943 and 1944 drafts of the unconscionability provision were worded specifically to handle this problem although it was rather badly drafted: see p. 205, *supra*.

procedural unconscionability under § 2-302 may not necessarily be described by reference to a term which conveys blameworthiness on the side of traders. Considered in this light, Leff's description of procedural unconscionability as "bargaining naughtiness"[50] can be criticised as inapposite. Indeed, this criticism can also apply to the scenario involving inability to understand contract terms which will be discussed shortly.[51]

Since the enactment of § 2-302, the courts appear to have reckoned the lack of reasonable opportunity to read contract terms when making the determination of unconscionability.[52] It must be noted, however, that decided cases do not hold that mere failure to read can sufficiently vindicate a claim of unfair surprise under the unconscionability section. Rather, the courts have struck down contract terms in favour of the disadvantaged party when it appeared that the reading was prevented by the absence of reasonable chance to read or study the terms.[53]

3.2.1.3 Inability to Understand Contract Terms

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[50] Leff, *op .cit.*, (footnote 26, *supra*), at 487.

[51] *Cf.* EC Directive on Unfair Terms in Consumer Contracts under which procedural unfairness is assessed by reference to "good faith". This appears conceptually unsound: see Chapter 5, *infra*.

[52] See *Williams* v. *Walker-Thomas Furniture Company* (1965) 350 F.2d 445, at 449-450; *Industralease Automated & Scientific Equipment Corp.* v. *R.M.E. Enterprises, Inc.* (1977) 396 N.Y.S.2d 427 (disclaimer of express and implied warranties in a lease of an incinerator was held unconscionable, *inter alia*, because "the atmosphere of haste and pressure on the defendants [lessee] is clearly pervasive"); *Bank of Indiana, NAT. Ass'n* v. *Holyfield* (1979) 476 F. Supp 104, at 110 ("a lack of knowledge is demonstrated by a lack of understanding of contract terms arising from inconspicuous print or use of complex legalistic language, disparity and sophistication of parties, and lack of opportunity to study the contract and inquire about the contract terms...").

[53] See *Veeder* v. *NC Machinery Co.* (1989) 720 F. Supp 847, 10 UCC Rep Serv 2d 841, at 844 (a clause limiting the seller's liabilities to the replacement for defective goods was held not unconscionable when the buyer had the opportunity to be familiar with the provisions of the contract and the fact that the party did not wear glasses and thus could not read the contract was no defence); *Gillman* v. *Chase Manhatton Bank* (1988) 7 UCC Rep Serv 2d 945, at 951 (a term in a security agreement allowing a transfer of funds without notice was held not unconscionable when the party, though unaware of the term, had time to study it and to discuss it with a lawyer); *Wilson* v. *World Omni Leasing, Inc.* (1989) 8 UCC Rep Serv 2d 628, at 633 (a term providing that the lessee was liable for the balance due under the lease even though the property was destroyed in an accident and the insurance proceeds were insufficient to liquidate the balance was held not unconscionable when the party had the ability to read and understand an instrument but consciously decided not to do so). The court in *Wilson's case* affirmed the position proclaimed in *Syx* v. *Midfield Volkswagen, Inc.* (1987) 518 So.2d 94 that simply not exercising any degree of precaution to safeguard one's interests gave rise to no remedy.

Even the combination of conspicuousness and availability of reasonable time to read contractual terms is not necessarily a proxy for a party's real consent if that party fails to understand legal effects of the terms concerned. As elaborated in Chapter 1, inability to comprehend consequences of contract terms is commonplace when written, mostly standardised, contracts in modern markets are phrased in complex and garrulous terms not understandable to laypersons. Section 2-302 also encompasses this incident under its "unfair surprise" rubric.

Indeed, *Williams* v. *Walker-Thomas Furniture Company*[54] is an early "unconscionability" case wherein a party's understanding of contract terms was explicitly considered by the court. The passage below indicated that the court described procedural unconscionability as the lack of "meaningful choice" which, in the court's view, includes the lack of apprehension.

> "In many cases, the meaningfulness of the choice is negated by gross inequality of bargaining power. The manner in which the contract was entered into is also relevant to this consideration. *Did each party to the contract, considering his obvious education or lack of it, have a reasonable opportunity to understand the terms of the contract*, ... ? Ordinarily, one who signs an agreement without full knowledge of its terms might be held to assume the risk that he has entered a one-sided bargain. (Citation omitted.) But when a party of little bargaining power, and hence little real choice, signs a commercially unreasonable contract with little or no knowledge of its terms, it is hardly likely that his consent, or even an objective manifestation of his consent, was ever given to all the terms. In such a case, the usual rule that the terms of the agreement are not to be questioned should be abandoned and the court should consider whether the terms of the contract are so unfair that enforcement should be withheld."[55]

The courts in subsequent cases have consistently taken account of inability to comprehend contract terms when determining procedural unconscionability under § 2-302. As with the conspicuousness or lack of reasonable opportunity to read contract terms, in most cases this deficiency occurred in combination with other procedural defects. In *Unico* v. *Owen*,[56] the waiver-of-defence clause was, in addition to its fine print and inconspicuous location, not comprehensible to the party and its significance

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[54] (1965) 350 F.2d 445.

[55] *Ibid.*, at 449-450.

[56] (1967) 232 A.2d 405, at 407.

was not explained. Likewise, in *Fleischmann Distilling Corp.* v. *Distillers Co. Ltd.*,[57] factors determinative of procedural unconscionability were stated to include: "*whether the important terms of a contract were understood*, whether high-pressure or deceptive sales practices were utilized, whether terms were hidden in fine print and whether there was gross inequality of bargaining power".[58]

As demonstrated in Chapter 1, inability to understand the implications of complex clauses does not necessarily involve such an element of advantage-taking as perceived in equity. Given that the existing common law and equity generally does not give remedy to an ignorant party in a contract unplagued with unconscientious advantage-taking,[59] the unconscionability doctrine as embodied in § 2-302 goes beyond the coverage of the traditional canons as far as it empowers the courts to undo clauses in a contract concluded without the aggrieved party fully understanding the undesirable consequences of the clauses. Viewed from this angle, another respect is found in which this statutory doctrine is not merely a restatement of equity but also serves as a gap-filler of such traditional incantation of contract law.[60]

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[57] (1975) 395 F. Supp 221, at 232 (italics added).

[58] See also *Schroeder* v. *Fageol Motors, Inc.*, *op. cit.*, (footnote 45, *supra*); *Bank of Indiana, NAT. Ass'n* v. *Holyfield*, *op. cit.*, (footnote 52, *supra*); *Wilson* v. *World Omni Leasing, Inc.*, *op. cit.*, footnote 53, *supra*; *Carlson* v. *General Motors Corp.* (1989) 883 F.2d 287, at 293 (factors indicative of unconscionability include "relative sophistication"); *MacDonald* v. *First Interstate Credit Alliance, Inc.* (1989) 10 UCC Rep Serv 2d 1057 ("omnibus clause" which, in order to secure payment arising from an equipment purchased and financed, gave a finance company a security interest not only in that equipment but also in other goods previously purchased although wholly paid off was held unconscionable when it was not established that the unsophisticated debtor understood the clause); *Polygram S.A.* v. *32-03 Enterprises, Inc.* (1988) 697 F. Supp 132, 8 UCC Rep Serv 2d 914 (a clause in sale contract exonerating the seller's liability for defective goods if not returned within 90 days of receipt of the goods was held not unconscionable when the buyer had knowledge of the terms and conditions of the industry); *Tassan* v. *United Development Co.* (1980) 410 N.E.2d 902 (mere conspicuousness was not sufficient to show that a disclaimer of the implied warranty of habitability in a sale of a new residence was in fact the agreement reached and it must be proved that the buyer knew that the implied warranty did not attach to the sale); *Weaver* v. *American Oil Company* (1971) 276 N.E.2d 144, at 148 ("the party seeking to enforce such a contract has the burden of showing that the provisions were explained to the other party and came to his knowledge and there was in fact a real and voluntary meeting of the minds and not merely an objective meeting").

[59] See pp. 199-201, *supra*.

[60] Spanogle, in *op. cit.*, (footnote 41, *supra*), at 953, seems to appreciate this development when he says: "even an incomprehensible clause that is not necessarily overreaching may now be a liability under the Code, since the non-drafting party cannot understand it."

3.2.2 "Oppression"

The other type of procedural unconscionability is "oppression". The word "oppression" was first inserted in the official comment in the 1952 draft. Before this draft, the principle of § 2-302 was merely stated as "one of the prevention of unfair surprise". In the 1952 draft, the said principle was changed into "one of the prevention of oppression and unfair surprise". Although it is inarguable that the significance of "unfair surprise" lies in the knowledge and understanding of the contract or clause concerned, it is not clear-cut what is meant by "oppression". However, the following possibilities have been suggested.

3.2.2.1 "Oppression" as Substantive Unconscionability

It might be argued that "oppression" refers to the harshness in the result of a contract or its clauses, not to anything in the bargaining process. In other words, it describes substantive unfairness rather than procedural unfairness. It is undeniable that the word "oppression" is occasionally used in the substantive dimension to connote some harsh effect of the contract or clause suffered by the complaining party.[61] But, as far as § 2-302 and its Official Comment is concerned, granting that "oppression" signifies the substantive dimension is fraught with difficulty since it would follow that harshness alone is sufficient for a finding of unconscionability under the Code. This interpretation patently runs counter to the statement in the Comment itself: that the principle of this section is "not one of disturbance of allocation of risk because of superior bargaining power". Therefore, "oppression" should be intended to clarify something in the bargaining process.

3.2.2.2 "Oppression" as Overreaching in Equity

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[61] See, for example, Comment C to § 1-208 of the Restatement (Second) of Contracts: "Theoretically, *it is possible for a contract to be oppressive taken as a whole, even though there is no weakness in the bargaining process* and no single term which is in itself unconscionable. Ordinarily, however, an unconscionable contract involves other factors as well as overall imbalance". The term "oppressive" in this context obviously refers to unfairness in the substantive result. See also *Dale R. Horning Co., Inc.* v. *Falconer Glass Industries, Inc.* (1990) 11 UCC Rep Serv 2d 536 at 544 where McKinney J. considered the question of "hardship" under § 2-207 and its Official Comment (concerning "battle of forms") and, referring to Webster Encyclopedic Dectionary, defined hardship as something "hard, oppressive, toilsome, [or] distressing".

Those who raise an objection to the interpretation that "oppression" signifies procedural unconscionability might content themselves with the argument that if various types of procedural deficiencies are already caught by the locution "unfair surprise" there will hardly be anything left for the operation of "oppression". This argument is largely misconceived. It must be recalled that procedural unconscionability framed under "unfair surprise" is merely directed to the three types of ignorance: inconspicuousness, want of reasonable opportunity to ascertain contract terms, and lack of comprehension. There exist other forms of procedural unconscionability which stand beyond the elements above and which can consequently be framed under "oppression".

These forms of procedural unconscionability are those involving the exercise of unconscientious means to secure an agreement—the advantage-taking of one party's position. We have, indeed, seen from a previous section of this Chapter that this is the type of procedural impropriety which falls within the operation of equity. To import such a situation into § 2-302 under the "oppression" guide is thus no more than to restate existing equity. However, given that the application of equity is typically limited to real property transactions, the "oppression" arm of § 2-302 has the effect of extending the equitable relief to other transactions as well.

In this connection, Leff sounds an alarm that the importation into the statute of such a vast body of decisions and learned commentary as the equity doctrine involves maybe an "unhappy implantation in alien soil".[62] Leff observes that equity doctrines have been developed and generally applied in transactions involving *real property or land*. This is because, Leff elaborates, real property is likely the only thing that the relatively unsophisticated have which is worth tricking them out of and there arise those repeated dramatic vignettes with which the Chancellors were continually faced. Leff thus believes that when § 2-302 incorporates equitable doctrines and applies them also to *chattel* transactions, which are usually mass transactions, the likelihood of overreaching or unconscientious means appears slender. This contention seems weak. Despite the truism as regards the typicality of the overreaching in land transactions, it

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[62] Leff, *op .cit.*, (footnote 26, *supra*), at 535.

is of little sense to disapply the same doctrines concerning the overreaching to chattel transactions where such unconscientious conduct is found. In addition, although the equitable doctrines have been developed from land transactions, there has never been any judicial qualification attached to the doctrines to the effect that they cannot be applied to transactions other than those involving real estates. Leff contends further that it is some special attributes of land that call for special judicial concern. These special attributes lie in the following facts: that a real estate transaction is likely to be economically significant for the parties; that such a transaction is likely to be a one-in-a-lifetime transaction; and that land is treated as unique and intrinsic in character.[63] Again, albeit this truism is appreciated, there is no *a priori* reason to exclude from chattel transactions judicial supervision *vis-à-vis* unconscientious means exerted in the process of contract-making. With respect, Leff's arguments seem to lose credibility.

Notwithstanding the counter-arguments above, this thesis suggests that § 2-302 would prove a more efficient safeguard against unfair terms if the equitable doctrine which concerns the unconscientious advantage-taking had not been integrated into it under the framework of "oppression". However, the reason for this suggested exclusion does not rest upon Leff's contention but, rather, lie in the avoidance of the confusion which is prone to arise from the increasing level of abstraction in judicial reasoning if the situations involving advantage-taking of circumstances of weakness and other situations are to be treated under the same rule. This will be demonstrated in the last part of this Chapter.[64]

3.2.2.3 "Oppression" as Take-It-or-Leave-It or Inequality of Bargaining Power

Most often, "oppression" as appears in the Official Comment has been addressed by commentators as concentrating on the element of "take-it-or-leave-it" in adhesion contracts, or the fact that one party possesses a superior bargaining power when making the contract with the other.[65] Undeniably, although some pre-prepared

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[63] *Ibid.*, at 535-536.

[64] See pp. 243 *et seq*, *infra*.

[65] See Ellinghaus, "*In Defense of Unconscionability*", (1969) 78 Yale L.J. 757, at 766-768; Spanogle, *op. cit.*, (footnote 41, *supra*), at 944 ("There are many transactions in which one party...has no choice

written contracts or standard forms of the industries may allow further negotiations leading to some alteration or modification of contract terms, most preprinted or form contracts are of the adhesive nature. Nevertheless, it is erroneous to grant that the mere fact that an agreement is made on a take-it-or-leave-it basis, on which the drafting party possesses a stronger bargaining power than the non-drafting party, is sufficient to constitute "oppression" and unconscionability, even if the substance of the term in question is far more favourable to the former.

It should be recalled that the use of pre-printed forms without allowing non-drafting parties to negotiate and alter the contents is recognised as essential for business convenience and economic utility. If a contract clause is destructible on the mere ground of this adhesive feature, the long-recognised advantages of the use of form pads are totally undermined. Some other factors indicative of procedural deficiency such as inconspicuousness or incomprehensibility must be found in an adhesion contract before it or its clause can be declared unconscionable. In the absence of such additional factors, a non-drafting party who has made the contract on the agreed terms should be taken to have judged the terms worth taking in spite of the disproportionate imbalance. Indeed, this reasoning applies to general cases of adhesion contracts, whether they are standard-form contracts or not. It is noted that even Llewellyn, the founder-father of this unconscionability provision has appeared to bear in mind the advantages and necessity of the use of form-pads and their adhesive nature.[66] It would be, therefore, very unlikely that the statutory unconscionability doctrine was intended to allow adhesion or inequality of bargaining power *per se* to be a basis for judicial review of contract clauses. Unsurprisingly, the Official Comment

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of the terms of the contract—contract of adhesion. Present concepts of duress do not reach such conduct, but opportunities for abuse are abundant, and protection can be provided through a concept of oppression..."); Trudy N. Sargent, "*Unconscionability Redefined: California Imposes New Duties on Commercial Parties Using Form Contracts*", (1983) 35 Hastings L.J. 161, at 165. See also J.J. White and R.S. Summers, *Uniform Commercial Code* (*Handbook Series*), 3rd edn., (West Publishing Co., 1988), § 12-11, p. 606, at 611, 612 where it is conceded that a disclaimer may be "oppressive" within the meaning of Comment 1 to § 2-302 because although it may be conspicuous and actually understood by the buyer a seller has a strong bargaining position that he can impose a perfectly drafted disclaimer, which operates to deprive the buyers of virtually all protection that the law would otherwise provide, and he refuses to bargain at all concerning its scope.

[66] Llewellyn, *The Common Law Tradition*, *op. cit.*, (footnote 42, *supra*), p. 362.

luminously pronounces that the principle of § 2-302 is "*not* one of disturbance of allocation of risks *because of superior bargaining power*". It is worth noting that the same position is adopted by § 1-208 of the Restatement (Second) of Contracts. Comment d. to this Restatement states: "A bargain is not unconscionable merely because the parties to it are unequal in bargaining position, nor even because the inequality results in an allocation of risks to the weaker party".[67] It is further noted that the Preliminary Report of the Study Group[68] seems to suggest that the Official Comment to § 2-302 be revised to state clearly that a contract or its clause cannot be declared unconscionable if the contracting party "has [sic] adequate information about the content of a writing but had limited choice".

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[67] This sentence is followed by the following: "But gross inequality of bargaining power, together with terms unreasonably favorable to the stronger party, may confirm indications that the transaction involved elements of deception or compulsion, or may show that the weaker party had no meaningful choice, no real alternative, or did not in fact assent or appears to assent to the unfair terms." At first blush, this might convey the impression that "gross inequality of bargaining power", as contrasted with ordinary inequality stated in the preceding sentence, is taken as *conclusive* evidence of fraud, unconscientious means or other procedural defects and that a harsh clause can consequently be destructible on the mere ground of such gross inequality. However, on further analysis, this appears to be the wrong interpretation. What is meant is only that gross inequality signals the likelihood of other factors indicative of procedural unconscionability which the court is cautioned to investigate. This line of interpretation is buttressed by the fact that the next, and the final, sentence of this Comment enumerates factors which may contribute to a finding of unconscionability in the bargaining process, which are stated to include the following: belief by the stronger party that there is no reasonable probability that the weaker party will fully perform the contract; knowledge of the stronger party that the weaker party will be unable to receive substantial benefits from the contract; knowledge of the stronger party that the weaker party is unable reasonably to protect his interests by reason of physical or mental infirmities, ignorance, illiteracy or inability to understand the language of the agreement, or the similar factors. If this Comment is interpreted as meaning that mere gross inequality suffices to render a harsh clause destructible, the enumeration of these factors in the concluding sentence of this Comment is obviously unnecessary. Moreover, the illustration given by the Comment is obviously extracted from the facts in *Frostifresh* v. *Reynoso* (1968) 274 N.Y.S.2d 757 which concerned a contract between a commercial seller and unsophisticated buyers for the sale of a refrigerator-freezer which cost the seller only $348. Although the inequality of bargaining power was much in evidence, there were present various additional facts involving the advantage-taking and lack of knowledge: the salesman distracted and deluded the buyers that the appliance would cost them nothing because they would be paid numerous $25 commissions on sales to their neighbours or friends whereas in truth the total payment required by the contract was $1145.88 ($900 cash price plus $245.88 credit charge; the buyers were Spanish-speaking, illiterate in English and ignorant of both the commercial situation and the nature as well as terms of the contracts which were written in English. From this factual analysis, this contract was not declared unconscionable on the sole ground of gross inequality of bargaining power.

[68] *Op. cit.*, (footnote 26, *supra*), p. 80.

In this connection, Leff, discussing the intention of draftsmen of the unconscionability provision in relation to a form-pad and its adhesive nature, appears to realise that the use of form contracts is hardly a *malum in se* and that it is a social good and the contracting-process component of mass transaction which will contribute to economic utility. On this standpoint, Leff concedes that if the new device of the unconscionability provision makes all printed forms open to after-the-fact *ad hoc* judicial second guessing, there is the danger that the efficiency of mass transactions will be seriously impaired. He, therefore, concludes that the element which triggers scrutiny for unconscionability is not the mere use of a form but "the use of a form *plus something else*".[69] Leff also points out the view taken by some commentators that the additional factor is the fact that the purveyor of a pre-printed contract is in the position to put the other party to a take-it-or-leave-it option without giving that other party the right to co-determine the contract. To these commentators, "the procedural unconscionability component of section 2-302 is at the adhesion contract level rather than at the mere form-contract level."[70] This view, if taken, runs into a tremendous inconsistency. When, as a matter of fact, the use of a pre-prepared form-pad, in order to be advantageous to mass transactions and contributory to economic utility, requires its acceptance in the take-it-or-leave-it fashion, attacking its adhesive feature and insisting upon a right of co-determination is, in reality, an attack on its use although it is rhetorically expressed that the mere use of form-contracts is not attacked. In this regards, Leff's view deserves this thesis's concurrence: if the word "oppression" in the Comment to § 2-302 means that a term can be meddled with when the aggrieved party could not effectively have objected to it even if he knew about it and understood it (i.e. no surprise), it would have been well to do so in a somewhat less Delphic manner than by the unexplained insertion of the single word "oppression".[71]

A survey into cases decided under § 2-302 has shown that in most cases in which the take-it-or-leave-it fashion was taken into the courts' consideration there

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[69] Leff, *op. cit.*, (footnote 26, *supra*), at 504.

[70] *Ibid.*, at 508.

[71] *Ibid.*, at 500.

were also found other factors indicating procedural unconscionability beyond the mere adhesive element of the contract in question. The following affords illustrations. In *MacDonald* v. *First Interstate Credit Alliance, Inc.*[72] wherein the "omnibus clause" which granted the financing company a security interest in everything the debtor owned (whether financed by the lender or not and, if so financed, whether wholly paid off by the debtor or not) was held unconscionable, although the court was concerned that the agreements in question were standard-form contracts offered on a take-it-or-leave-it basis, the judicial reasoning concerning unconscionability also rested upon the inability of the debtor to understand the clause. In the court's words: "the record does not reflect that MacDonald fully understood those provisions... . It has not been shown that First Interstate in dealing directly with MacDonald explained their meaning and that there was in fact a real and voluntary meeting of the minds and not merely an objective meaning."[73] In another case[74] in which a clause limiting a water pipe producer's liabilities to the replacement for a defective product was held unconscionable, the fact that the seller possessed a substantially superior bargaining power and presented a pre-printed form without allowing negotiation was initially invoked by the court as the crucial factor indicative of procedural unconscionability.[75] However, the court then noted that the facts demonstrating an actual lack of negotiation were coupled with elements showing unfair surprise,[76] which in this case existed when the contract clauses were contained in an installation guide expressly

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[72] (1989) 10 UCC Rep Serv 2d 1057.

[73] *Ibid.*, at 1065. Another clause, a "cross-collaterlization" clause, contained in the same agreement was held not unconscionable although contained in a form-contract and found in fine print boilerplate. The court stated that the inclusion of such provisions was common in the industry and the debtor was thus obviously aware of them. This illumines the court's concern with knowledge and understanding of the clause, not with the mere adhesive nature of the contract.

[74] *Construction Associates, Inc.* v. *Fargo Water Equipment Co.* (1989) 446 N.W.2d 237, 10 UCC Rep Serv 2d 821.

[75] 10 UCC Rep Serv 2d 821, at 827 where the court said: "The circumstances... demonstrate a substantial inequality in bargaining power between J-M and Construction Associates. Construction Associates is a relatively small local construction firm, while J-M is part of an enormous, highly diversified, international conglomerate. The limitation of remedies...were part of a pre-printed installation guide included with all shipments of J-M Pipe..."

[76] *Ibid.*, at 827.

directed to the worker in the field and not provided to the buyer until long after the sales contract had been finalised.[77]

Likewise, in *Martin* v. *Joseph Harris Co., Inc.*[78] wherein the disclaimer of warranties as well as exclusion of remedies printed in an order form for cabbage seed was reviewed *vis-à-vis* unconscionability, the court, clearly proclaiming that relative bargaining power of the parties was appropriate consideration, noted that the *proferens* was a large national producer and distributor of seed dealing there with independent and relatively small farmers. At first blush, this might carry the impression that the court held the clause unconscionable on the ground that the farmers were pushed to take or leave the contract. But, in reality, the court inquired into other pertinent factors including alternative source of supply and knowledge, on the part of the purchasers, of the clause and its significance. It was found that the purchasers were "uncounseled laymen" and unaware that the clause in question altered significant statutory rights.[79]

Also, in *Graham* v. *Scissor-Tail, Inc.*[80] which concerned a promotional agreement between a promoter and a group of rock musicians, the court seemed to declare the clause in question unconscionable on the mere ground that the contract was "the product of circumstances suggestive of adhesion", for there existed no factors indicative of surprise. However, in truth, unconscionability in this case did not stem from adhesion alone. There was a near-monopolistic element in that this musicians' group was a member of the American Federation of Musicians (A.F. of M.), the musicians' union, which represented nearly all significant musicians and mandated that all promotional agreements members made with promoters be subject to standard union-prepared contracts. The courts deciding unconscionability have hardly been seen finding procedural unconscionability from the take-it-or-leave-it feature without

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[77] *Ibid.*, at 828.

[78] (1985) 767 F.2d 296.

[79] *Ibid.*, at 301.

[80] (1981) 623 P.2d 165

more.[81] It is noteworthy that the same is true of the courts deciding the "public policy" issue.[82]

It is also worth observing that, in a number of cases, although the courts have apparently spoken of "inequality of bargaining power" as being an important element of unconscionability under § 2-302, the courts may have used such term in a broad sense, the sense which includes such factors as sophistication or knowledge of the parties, as opposed to the narrow sense of mere adhesion or "take-it-or-leave-it" entry. In such cases, the judicial consideration of inequality of bargaining power should not be misunderstood as the courts' proclamation that mere adhesion renders a contract clause unconscionable even if the disadvantaged party knew of the clause and fully understood its implications at the time of contracting. *Hydraform Products Corp.* v. *American Steel*[83] provides an illustration. In this case, when a clause limiting a steel supplier's liability for consequential damages to the replacement for defective products or refund of the purchase price was challenged, the court stated that the principle of §

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[81] See also *Perdue* v. *Crocker NAT, Bank* (1985) 702 P.2d 503, at 511 (the court agreed with the pronouncement in *Graham* v. *Scissor-Tail, Inc.*, *supra*: "To describe a contract as adhesive in character is not to indicate its legal effect...A contract of adhesion is fully enforceable according to its terms [citation] unless certain other factors are present which, under established legal rules—legislative or judicial—operate to render it otherwise"); *Weaver* v. *American Oil Company* (1972) 276 N.E.2d 144 (although the lease in question was given on a take-it-or-leave-it basis, there were also found the party's lack of sophistication as well as the fine print with no title heading).

[82] A striking illustration is to be found in *Delta Airlines, Inc.* v. *Douglas Aircraft Company, Inc.* (1965) 47 Cal. Rptr. 518 wherein the court, in determining whether a clause in a contract for sale of a commercial airplane exculpating the seller from liabilities for negligence was void as against public policy, inquired the element of inequality of bargaining power and reached the conclusion that although the clause was part of Douglas' standard form the clause was clearly open to negotiation and thus the contract was not the kind of compulsion to which the "adhesion" doctrine applied. The exculpatory clause was therefore upheld: *ibid.*, at 523. It might, at first glimpse, be argued that had the contract not been open to negotiation, the clause would have been held repugnant to public policy on the sole ground of adhesion. However, such an interpretation cannot stand, for it appeared that the court looked into other procedural mishaps: experiences and knowledge of the clause, fine print, alternative source of supply: *ibid.*, at 523. Moreover, the court also referred to *Tunkl* v. *Regents of University of California* (1963) 383 P.2d 441 in which a similar clause was disapproved when the party invoking exculpation, a hospital, confronted the public with a standardised adhesion contract and thus exercised a decisive advantage of bargaining power. The court in *Delta Airline* noticed that the condemnation of the clause in *Tunkl* was mainly prompted by "public interest" (namely, the fact that the contract concerned the service of great importance to the public) and thought that in the contract between Delta and Douglas no such public interest was present: *ibid.*, at 523, 524. This elucidates the court's recognition that adhesion or "take-it-or-leave-it" *per se* does not suffice to attract judicial attack.

[83] (1985) 498 A.2d 339.

2-302 was that of overreaching and that the most common indicator of overreaching was the relative bargaining power of the parties. It was further explained that although (ordinary) superior bargaining power by itself was not enough to vindicate overreaching and then taint a clause, the bargaining power which was "so disparate that the weaker party was left without any genuine choice" could establish overreaching.[84] This statement may inadvertently generate the interpretation that gross superiority of bargaining power alone rendered the clause in question unconscionable. But, in reality, when the court looked into such level of disparity of bargaining power, the court spelled out that the party claiming unconscionability was not an innocent in the industry, had access to competitors and had known of the clause in the course of the trial run contract. Based on these facts, it was held that the clause was without surprise and thus not unconscionable. Obviously, "disparity of bargaining power" in this context was used in a broad sense which swept the elements which indeed could have been more directly stated under the "surprise" locution.

Similarly, in *Kerr-McGee Corp.* v. *Northern Utilities, Inc.*[85]which concerned an indefinite price escalation clause in a contract for the sale of interstate natural gas between gas utilities and gas producers, "gross inequality of bargaining power" was first clearly stated as one of the considerations relevant to the determination of unconscionability.[86] The court then held the clause not unconscionable because it was shown that "experienced negotiators for both parties entered into an agreement after several months of give-and-take" and that "Northern was not compelled to enter into the contract and clearly believed the contract terms were to its advantage at the time of execution and for several years thereafter".[87] This speech might look like the court uttering that the clause in question was not unconscionable because it was not entered on a take-it-or-leave-it basis. Nonetheless, it is hardly deniable that the court's mention of "experience" and "the belief in the advantages of the terms" was in fact the court's

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[84] *Ibid.*, at 344.

[85](1982) 673 F.2d 323

[86]*Ibid.*, at 329.

[87]*Ibid.*, at 330 (italics added).

reckoning of additional factors in determining unconscionability—the factors which the court may have subsumed under the broad term "inequality of bargaining power".

Finally, it should be reiterated that when "inequality of bargaining power" is spoken in its narrow sense to describe the adhesive nature of the contract-making, striking a clause merely on this ground is patently at variance with the principle stated in the Official Comment the observance of which has indeed been visualised in numerous cases decided under § 2-302. In *Philipps Machinery Co.* v. *LeBlond, Inc.*[88] which concerned a provision in a distributorship agreement excluding damages for lost profits resulting from the cancellation of the agreement, the court clearly expressed:[89]

> "There is no requirement that there be inequality of bargaining power. The comment to § 2-302 makes it clear that the section does not invalidate clauses simply because they allocate risks to the party having less bargaining power. ...".[90]

3.2.2.3 "Oppression" as Monopoly

"Oppression" under § 2-302 can operate against the situation where an absence of meaningful choice of a party is caused by monopoly as well. At a conceptual level, it is arguable that where monopoly exists in commodities classified as necessities, consumers can be said to be forced to take the goods on monopolistic terms, in which case the "oppression" device under § 2-302 can be resorted to. But the existence of monopoly in the U.S. context is hardly so common as to compel the invocation of this unconscionability section in this regard. One scarcely witnesses such a case in which a contract clause was declared unconscionable on the ground of monopoly alone. Indeed, in most cases, adjudications ran in the opposite direction—contract clauses were declared not unconscionable because the claimant party had several other

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[88] (1980) 494 F. Supp 318.

[89] *Ibid.*, at 323.

[90] See also *Majors* v. *Kalo Laboratories, Inc.* (1975) 407 F. Supp 20, at 23 where the court stated that it did not rely upon any disparity in bargaining power as the Official Comment suggested that such a consideration would be inappropriate.

suppliers or alternative choices in the market.[91] In very few cases, the courts applied the unconscionability doctrine to the situation where goods or services were supplied on the same term although several sources of supply existed.[92] Nevertheless, some other forms of procedural unconscionability were also found in these very few cases.[93]

Monopoly was once dominantly found in *Henningsen* v. *Bloomfield Motors, Inc.*[94] which has been previously discussed in Chapter 1 but merits specific elaboration here. There, the attempted disclaimer of an implied warranty of merchantability was held "so inimical to the public good as to compel an adjudication of its invalidity".[95] The court clearly announced that the Sales Act authorised agreements between the parties qualifying the warranty obligations but such agreement was to be arrived at freely.[96] But, in this case, it appeared that the warranty in question was the uniform warranty of the Automobile Manufacturers Association whose members included companies then representing 93.5 per cent of the passenger-car production. In view of this, the court spelled out that when there was no competition amongst car makers in

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[91] See, for example, *Polygram, S.A.* v. *32-03 Enterprises, Inc.* (1988) 697 F. Supp 132, 8 UCC Rep Serv 2d 914, at 920 (the "90-day return" provision was held not unconscionable when court noted that the buyer's contention that there was an absence of meaningful choice was contrary to the buyer's document which indicated that there were several other manufacturers with whom to contract); *Peacock* v. *Ciba-Geigy Corp.* (1980) 8 UCC Rep Serv 2d 688 at 690 (a disclaimer of liability for consequential damages was not unconscionable since the plaintiff was free to choose from a number of herbicides in the market and was familiar with the contract terms).

[92]The leading case is *Allen* v. *Michigan Bell Telephone* (1969) 171 N.W.2d. 689, at 691-692 where the court pronounced: "Where goods and services can only be obtained from one source (*or several sources on non-competitive terms*) the choices of one who desires to purchase are limited to acceptance of the terms offered or doing without. Depending on the nature of the goods or services and the purchaser's needs, doing without may or may not be a realistic alternative. Where it is not, one who successfully exacts agreement [sic] to an unreasonable term cannot insist on the court's enforcing it on the ground that it was "freely" entered into, when it was not... ." (italics added).

[93]See *Martin* v. *Joseph Harris Co., Inc.* (1985) 767 F.2d. 296, at 301 where it was shown that the purchasers were unaware of the implications of the disclaimer in question.

[94] (1960) 161 A.2d 69.

[95] *Ibid.*, at 95. Although Henninsen's case was not decided under UCC § 2-302, its conclusion that a warranty disclaimer was inimical to public policy is precisely the type of the conclusion that the Code intends for a court to reach under § 2-302, so that the reasoning in Henningsen can be applied when determining unconscionability under the Code: see White & Summers, *Uniform Commercial Code*, *op. cit.*, (footnote 65, *supra*), § 12-11, p. 606, at 612.

[96] *Ibid.*, at 95.

the area of the express warranty, the buyer could not go to negotiate for better protection.[97] However, it must be noted that in this instant case monopoly was not the sole ground for holding the clause inimical to public welfare. There was, in fact, another factor suggesting that the clause was "unfairly procured" (not arrived at freely). This was the buyer's ignorance about the effect of the language of the clause which was felt to be "extremely difficult".[98] There, the court said:[99]

> "Assuming that a jury might find that the fine print referred to reasonably served the objective of directing a buyer's attention to the warranty on the reverse side, and, therefore, that he should be charged with awareness of its language, can it be said that an ordinary layman would realize what he was relinquishing in return for what he was being granted?... Any ordinary layman of reasonable intelligence, looking at the phraseology, might well conclude that Chrysler [manufacturer] was agreeing to replace defective parts and perhaps replace anything that went wrong because of defective workmanship during the first 90 days or 40,000 miles of operation, but that he could not be entitled to a new car... . *In the context of this warranty*, only the abandonment of all sense of justice would permit us to hold that...the phrase signifies to an ordinary reasonable person that he is relinquishing any personal injury claim that might flow from the use of a defective automobile."

3.3 Substantive Prong of Unconscionability

3.3.1 General

It is the substantive unconscionability which has generated much of criticism. The trepidation surrounds its amorphousness—what clause is treated as unconscionable in its substantive result when the court has satisfied that it has been acceded to by unfair surprise or oppression.

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[97] *Ibid.*, at 87.

[98] This disclaimer read:

> "The manufacturer warrants each new motor vehicle..., chassis or parts manufactured by it to be free from defects in material or workmanship under normal use and service. Its obligation under this warranty being limited to making good at its factory any part or parts thereof which shall, within ninety (90) days after delivery of such vehicle...or before such vehicle has been driven 4,000 miles, whichever event shall first occur, be returned to it with transportation charges prepaid and which its examination shall disclose to its satisfaction to have been thus defective; this warranty being expressly in lieu of all other warranties express or implied, and all other obligation or liabilities on its part..."

[99] *Ibid.*, at 93 (italic original).

The early drafts of the unconscionability section focused on unconscionability of *a contract as a whole* instead of unconscionability of a *single clause*. Section 24 of the 1943 draft provided that a party was not bound by a writing evidencing a contract if the writing was, *when read in its entirety*, an unconscionable contract. Leff has pointed out that the official comment to this section suggested that the criterion for entirety unconscionability was the elaborate lopsidedness or, in other words, the overall imbalance.[100] Obviously, this was targeted not at an ordinary imbalance but at such a gross imbalance as to give too much to one party and too little to the other. At the meeting of May 9, 1944 for considering this unconscionability section, Llewellyn, the original draftsman, explained:[101]

> "I think the background exactly represents the state of fact in 995 cases of the kind out of a thousand. I think that everybody who signs up on such a form knows perfectly well that he is signing a contract drawn to some extent in favour of the other party and against him, and he is perfectly willing to take a cake sliced 60-40 or perhaps even 75-25. But when it gets to be a cake sliced 99-1, he doesn't find that that is what he was agreeing to tacitly."

This "overall imbalance" formulation is, in fact, an account of pre-Code equity cases. Most of equity cases, as previously discussed, concerned gross overall-imbalance or gross inadequacy of consideration in transactions involving land or real property. The adoption of this account is not surprising when one recalls that the statutory doctrine of unconscionability received an inspiration from equity. However, gross overall imbalance should be gauged by reference to circumstances of each case rather than to any numerical precision such as 76-24 or 99-1.[102] Indeed, most § 2-302 cases in which the overall-imbalance notion was employed concerned inadequate or excessive prices for sellers or buyers as the case may be.[103]

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[100] Leff, *op. cit.*, (footnote 26, *supra*), at 512, quoting Informal Appendix to Revised Uniform Sales Act, Third Draft, 1943, Tentative Sketch of Material for Comments (1943).

[101] (1944) 21 The American Law Institute Proceedings, p. 114.

[102] It is noted that in 1954 Llewellyn described contestable imbalance as the taking of more than "80 per cent of the pie": see New York Law Revision Commission, *Hearings on the Uniform Commercial Code* (1954), pp. 121, 176-178, quoted in Spanogle, *op. cit.*, (footnote 41, *supra*), at 939 (note 28); see also Leff, *op. cit.*, (footnote 26, *supra*), at 514 (note 113).

[103] Some of these cases are discussed at pp. 236, 240, *infra*.

Notwithstanding, overall imbalance can also be found in contract clauses other than "price-terms". *United States Leasing Corporation* v. *Franklin Plaza Apartments, Inc.*[104] is perhaps of an instructive value. In this case, the seller of equipment, aware that the law protected the buyer in a retail instalment contract by allowing him to assert against the assignee (in the event where the seller assigned the contract to the assignee) any claim or defence which he might have against the assignor-seller, sought to circumvent this legal effect by the following drafting technique. Although all the negotiations were made with the buyer, the seller was not named a party to the contract. Instead, a third party was named a party to this contract and described as the "lessor" rather than "assignee" whereas the buyer was described as the "lessee" with the seller being referred to as the "Supplier". The contract, termed as a "lease", required the lessee to pay the lessor all rents despite any claims against the Supplier. This contract was held unconscionable because, when equipment to be supplied was not supplied, it had the effect of compelling payment for something which could not be used. Without the right to interpose a defence or set-off, the genuine buyer had nothing in value.[105]

Since the 1948 draft, the unconscionability section has not been restricted to the evaluation of overall imbalance. This section has empowered the court to make a finding of unconscionability of *any individual clause* as well. Such being the case, uncertainty arising out of amorphousness is more easily envisaged. Even though the ascertainment of the "overall imbalance" unconscionability cannot be said as problem-free,[106] it is never as problematic as the identification of "one clause" unconscionability.

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[104] (1971) 319 N.Y.S.2d 531.

[105] See also *Bank of Indiana, NAT. Ass'n* v. *Holyfield* (1979) 446 F. Supp 104 (a lease under which the lessor had nothing more to do other than collect the payments; the entire risk of loss fell on the lessees as the lessees were obligated to continue making payments even if leased cows were destroyed through no fault of the lessees); *Unico* v. *Owen* (discussed in Chapter 1, *supra*).

[106] Leff, *ibid.*, at 514, sounds an alarm: "If it is something like potatoes which arbitrarily have a "weight", then the measure of the weight *in those terms* is exact, but if it is a quality not attracted by gravity which is "weighed", then the weighing and balancing are not going to be more than metaphorically precise. Risks, for instance, do not have calibratable weight."

No definition is given by the Code regarding substantive unconscionability. No helpful guidance is provided. The statement in the Official Comment—"the basic test is, whether in the light of the general commercial background and the commercial needs of the particular trade or cases, the clauses involved are so one-sided as to be unconscionable under the circumstances existing at the time of the making of the contract"—serves as too general the guidance to be practically helpful. Yet, the ten pre-Code cases in the Comment are only reflective of unfair contents of disclaimers of warranties and limitations of remedies and bear no relevance to the determination of substantive unconscionability in other types of clauses.[107] It is the uncertainty which stems from this amorphous nature that has been much invoked for rejecting this statutory unconscionability doctrine. This point will be further discussed below.

3.3.2 Amorphousness

It is recognised that the amorphous quality of the substantive wing of "unconscionability" is intended by the draftsmen. Its determination is left to the total discretion of the courts who will examine commercial setting, purpose and effect of the clause concerned evidence as to which the parties are allowed, by subsection 2,[108] to present. Each case must be judged on its own particular facts. Spanogle demonstrates that the draftsmen expected a case-law gloss to build up quickly around the bare statutory words, thus establishing precedents to guide the courts. He, however, cautions that if one trusts courts to establish reasonable guidelines in the statutory language the safeguards against unintended expansion are adequate, but, without such trust, safeguards seem lacking.[109]

As far as this amorphousness is concerned, it is undeniable that uncertainty will unavoidably be confronted in the first few decades of the judiciary's application of this

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[107] Leff, *op. cit.*, (footnote 26, *supra*), at 525, concedes that the official-comment cases are totally incapable of providing any guidance for determining substantive unconscionability because those disclaimers or limitation clauses are, under the Code, not void. The Code (§§ 2-316 and 2-719) merely regulates them in regard to their conspicuousness. This view is now irrelevant when most courts have decided that §§ 2-316 and 2-719 are subject to § 2-302.

[108] See the text of this subsection quoted at p. 202, *supra*.

[109] Spanogle, *op. cit.*, (footnote 41, *supra*), at 941.

statutory doctrine. Nevertheless, this is the price to pay, in the initial period, for the protection of contracting parties in the long run. When solid guidelines have sufficiently been formulated by the development of case law, this uncertainty or unpredictability will be alleviated and the rejection of this doctrine on this ground will then cease to maintain its merit. As a matter of fact, since the promulgation of the UCC, hundreds of cases came to the courts for determination under § 2-302. More criteria for assessing fairness in the substantive results of contract clauses have been enunciated, implicitly or expressly. Given this, certainty and predictability is not impossible to achieve, at least to the extent which can keep industry's incentives alive.

As this thesis holds that it is not justifiable to let the "uncertainty" trepidation preclude the introduction of a general rule effectuating judicial review of contractual terms when sharp and appropriate criteria for assessing "unfair characters" of terms in an individual contract can be attempted, it is here believed that such criteria as so far articulated by the American judiciary over the period of thirty years of adjudication under their unconscionability section can be of practical value to the English legislature in designing or reforming the equivalent general rule in England. Indeed, it is arguable that in the era of globalisation of trade, the similarity of commercial environments in industrialised countries is likely to bring about similar types of unfair terms used in commercial contracts. The induction from case law of unfair characters of contract clauses will be dealt with in Chapter 6. The remaining section of this Chapter will only be devoted to examining merits and demerits of this unconscionability doctrine.

V: MERITS AND DEMERITS OF § 2-302 UNCONSCIONABILITY DOCTRINE

The attack on the doctrine of unconscionability under § 2-302 and the view that it is undesirable is principally founded upon the concern with uncertainty and unpredictability. However, as previously conceded, when appropriate criteria for determining an unfair character of a contract clause have been built up by the courts, this problem will then be ironed out. It follows therefore that if the residual conceptual framework of the doctrine is meritorious, this doctrine is thus worth adopting. In any event, provided that the supervisory regime is well-worked in the main, even if such indicators of unfairness as articulated by the judiciary are yet felt to be unsatisfactory

or mediocre, this inaptitude should be solved by the legislature working on appropriate guidelines and inserting them into this provision of the Code rather than by discarding the whole body of the doctrine itself. It will be demonstrated below that the residual analytical framework of this doctrine is laudable, worthwhile and, to a large extent, consistent with the framework which this thesis has proposed in Chapter 1. On the other hand, demerits surrounding this doctrine will also be pointed out with a view to imploring the reform.

1. Procedural Unfairness as Pre-Condition of Substantive Unfairness

In the first place, the doctrine can be praised for its respecting autonomy of will and rational judgments of contracting parties in that it does not subject substantive unfairness *per se* to judicial review. As previously explained, an unjust result of an individual clause can be held unconscionable only when caused by procedural deficiencies indicating an absence of consent on the part of the contestant party. The insistence upon both procedural and substantive components for a finding of unconscionability is tenacious. In *In Re Elkins-Dell Manufacturing Company*[110] which involved proceedings in bankruptcy on the issue of whether the referee could refuse to enforce a security agreement as being unconscionable, the court proclaimed that proof of the inequitable conduct of the claimant was necessary to warrant a finding of unconscionability and thought that the referee acted precipitously in judging unconscionability solely from the terms of the contract.[111] A case which is of particularly instructive value is perhaps *Construction Associates, Inc.* v. *Fargo Water Equipment*[112] where the court's analysis of unconscionability appeared judiciously systematic. The analysis began with the following recognition: "Courts and commentators have generally viewed the Code's unconscionability provisions within a two-pronged framework: procedural unconscionability, which encompasses factors relating to unfair surprise, oppression, and inequality of bargaining power, and

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[110] (1966) 253 F. Supp 864.

[111] *Ibid.*, at 870.

[112] (1989) 446 N.W.2d 237, 10 UCC Rep Serv 2d 821.

substantive unconscionability, which focuses on the harshness or one-sidedness of the contractual provision in question". Followed by this recognition was the court's first inquiring into procedural unconscionability and then, when procedural unconscionability was found, considering substantive unconscionability of the clause in question.[113] Although courts in some cases have held that mere substantive unconscionability is sufficient to have a clause struck down,[114] these are utterly wrongly decided and not represented by the majority of decided unconscionability cases.

It is noted that in some cases the courts declared a contract unconscionable without explicitly examining procedural unconscionability. But, in reality, the facts of

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[113] For other cases, see, for example, *Patterson* v. *Walker-Thomas Furniture* (1971) 277 A.2d 111, at 114 (price alleged to be in excess of fair value); *Johnson* v. *Mobil Oil Corp.* (1976) 415 F. Supp 264, at 268; *Bank of Indiana, NAT. Ass'n* v. *Holyfield* (1979) 476 F. Supp 104, at 109 (where the court said the doctrine of unconscionability was intended to "prevent oppression or unfair surprise and not to relieve a party from the effect of a bad bargain"); *A & M Produce Co.* v. *FMC Corp.* (1982) 186 Cal. Rptr. 114, at 121, 122.

[114] See, for example, *Remco Enterprises, Inc.* v. *Houston* (1989) 677 P.2d 567, at 572 where the court said unconscionability was a doctrine by which to deny enforcement of unfair contracts "because of procedural abuses arising out of the contract formation, *or* because of substantive abuses relating to the terms of the contract, such as terms which violate reasonable expectations of parties or which involve gross disparity in price" (italic original). The court made it clear: "either abuse can be the basis for a finding of unconscionability". In stating this position, the court relied on a Kansas case of *Wille* v. *Southwestern Bell Tel. Co.* (1976) 549 P.2d 903, at 907 where the court, considering a clause limiting a telephone company's liability for errors and omissions in yellow page advertising to the cost of such advertising, pronounced: "at the very least, some element of deception or substantive unfairness must presumably be shown". In reality, the use of the word "or" in *Wille* appeared more inadvertent than deliberate. The court clearly stated later that the doctrine was used to police an abuse of right to contract freely. Indeed, the court said: "it is directed not against the consequences *per se* of uneven bargaining power or even a simple old-fashioned bad bargain."

Similarly, in *Toker* v. *Westerman* (1970) 274 A.2d 78 which concerned a contract of sale of a refrigerator-freezer calling for the price 2½ times its reasonable retail value, the court, in holding this price unconscionable, relied, *inter alia*, on *Frostifresh Corp.* v. *Reynoso* (1966) 274 N.Y.S.2d 757 and stated that it was uniformly held that purchase price alone may be found unconscionable and bring the statutory provision into play. In truth, a careful analysis of *Reynoso's case* reveals that the excessive price in the contract in question ($1,145.88 whereas the cost of the appliance sold was $348.00) was struck down also because the purchaser failed to know and understand the total payment required by the contract when the total price was a complicated combination of cash price and credit charge of $245.88 and the buyer was a Spanish-speaking customer who was handicapped in English. It is, therefore, not a case of substantive unconscionability *per se* although the court seemed to express so. See also *Star Credit Corporation* v. *Molina* (1969) 298 N.Y.S.2d 570, at 575 where the court could not hold the price of a freezer unconscionable in the absence of proof of its actual value. It was, that is to say, implied that a price higher than the retail value of the goods was, by itself, to be regarded as unconscionable.

those cases reveal the presence of some procedural defects. Thus, the absence of judicial discussion of the procedural prong may not necessarily be squared with the court's disapproval of substantive unconscionability *per se*. A striking illustration is *American Home Improvement, Inc.* v. *MacIver.*[115] There, an agreement for home improvements charged the price of $2,568.60 which consisted of the value of goods and services of $959, the commission of $800 and the interest, and carrying charges of $809.60. Although the court said that the defendant received little or nothing of value, the unarticulated presence of procedural unconscionability was the failure to disclose to the homeowner finance charges as required by the statutes which were designed to "inform average individuals who have neither the capacity nor the strength to calculate the cost of the credit".

2. Responsiveness to Modern Market Conditions

Secondly, and more importantly, the doctrine is responsive to new market conditions and affords contracting parties remedy in situations against which they have been left unprotected by traditional rules of contract law. As earlier stated, although part of the unconscionability doctrine under § 2-302 is a mere restatement of the traditional incantation—the equitable doctrines as well as rules regarding incorporation of contract terms—the other end of this statutory doctrine provides for relief where the aggrieved party has entered into the contract either without a reasonable opportunity to ascertain the terms or without understanding their implications, so long as both situations are caught by the "surprise" net of this section. In addition, it is not intended to put a contract or any of its clauses on attack on the mere ground that it has been concluded on a take-it-or-leave-it basis, when the use of adhesion contracts is an advantageous and necessary impetus to the commerce and trade of the present epoch.

3. Sliding Scale Approach of Adjudication

Given the clarity about the purpose of the doctrine—rectifying substantive unconscionability only when caused by procedural unconscionability—the courts' determination of unconscionability should be systematic. A finding of unconscionability

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[115] (1964) 201 A.2d 886.

should be commenced with the inquiry into procedural impropriety and then followed by the evaluation of fairness of the substance of the term concerned, so that in the absence of procedural unconscionability it will be needless to proceed the unconscionability claim. A sliding scale (in the sense that the unfair substance of a contract or an individual clause is the presumption or evidence of procedural impropriety and thus makes the clear fact-finding of procedural unconscionability unnecessary or much less necessary) must be eschewed, for the courts may be persuaded to declare a contract or its clause unconscionable solely on the basis of its substantive unfairness, which will in reality amount to an attack on substantive unfairness *per se*, the formulation which the unconscionability doctrine seeks to avoid in the first place. Obviously, such formula will be detrimental to industry's incentives since consumers who have voluntarily and rationally entered into a contract may find it easy to circumvent the contractual obligations simply by filing a claim based solely on the substantive imbalance. Besides, the sliding-scale is likely to produce the following circularity: the deal is ruled bad because the party is incompetent while the party is ruled incompetent because the deal is bad. This circularity confuses the procedural-substantive conceptual framework of the doctrine itself. In this connection, Professor Hillman concedes, in an attack on § 2-302, that such confusing manipulation in the sense as explained above can be avoided by dispensing with the procedural-substantive framework and by acknowledging that unconscionability can be found without bargaining misconduct.[116] This is a doubtful contention. The framework of the doctrine is conceptually sound. It is the courts that have distorted the doctrinal robustness by introducing the sliding-scale in the face of the legislature's intention. Certainly, it would be more appropriate if the unconscionability provision could be reworded to carry a clear indication that procedural unconscionability is to be assessed by an actual fact-finding of the contract-making procedure, not by the sliding-scale inquiry into its substantive result.[117]

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[116] Robert A. Hillman, "*Debunking Some Myths About Unconscionability: A New Framework For U.C.C. Section 2-302*", (1981) 67 Cornell L.R. 1, at 22.

[117] As previously shown, the exemplary case in which a systematic analysis of unconscionability has been found is *Construction Associates, Inc.* v. *Fargo Water Equipment* (1989) 446 N.W.2d 237, 10 UCC Rep Serv 2d 821: see p. 235, *supra*.

4. Non-Interference with "Price" Terms

As this thesis maintains that "price terms" should be insulated from judicial review, it is of particular interest to investigate whether § 2-302 allows a party to contend that a contract price is unconscionable when it has been agreed to without his knowledge of cheaper sources of supply of the same goods or services. Unlike in the EC Directive which will be discussed in the next Chapter, no qualification is attached to § 2-302 to the effect of prohibiting the assessment of unfairness of prices or remunerations. Thus, on the one hand, a party might attempt to challenge an excessive price as unconscionable under the "unfair surprise" epithet—alleging that his subsequent knowledge of lower prices in the market has unfairly surprised him. If such an allegation is acclaimed under this statutory unconscionability provision, this would be erroneous for the reasons based upon the "realisation of expectation" which we have addressed in Chapter 1. On the other hand, § 2-302 and its "unfair surprise" apparatus can also be manipulated to outlaw price claims. It can be granted that no surprise exists in the light of payment of excessive prices. When "surprise" hinges on the lack of knowledge or understanding of terms *in the contract in question*, it cannot be discerned that the party who has agreed to such a high price with full knowledge and understanding of that price has been put in an unfair surprise *vis-à-vis* that price term. The subsequent awareness of cheaper sources of supply points to the surprise about prices (i.e. price terms) *in other contracts*, not the contract in question.

The unconscionability doctrine under § 2-302 has often been stated as striking an imbalance embodied in the form of price disparity. However, if such statement is intended to mean that most courts tend to have declared unconscionability on the sole ground price disparity *per se*,[118] this is indeed not to do justice to the courts. Of course, such erroneous decisions were occasionally given by the courts which erred in proclaiming that substantive unconscionability *per se* was sufficient to constitute § 2-

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[118] Such opinion is found in Gerald T. McLaughlin, "*Unconscionability and Impracticability: Reflections on Two U.C.C. Indeterminacy Principles*", (1992) 14 Loy. of L.A. Int'l & Comp. L.J. 439, at 445.

302 unconscionability.[119] But this is not representative of the general judicial enunciation. In most cases where price disparity was involved, the involvement was concretised in two fashions, neither of which epitomized contractual imbalance *per se*.

The first type concerns the situation where one party took advantage of circumstances of weakness of the other party. Again, this is the situation which was once under the supervisory jurisdiction of equity but subsequently falls within the ambit of § 2-302. *Jones* v. *Star Credit Corp.*[120] can provide an illustration. In this case, a home freezer unit which had an approximate retail value of $300 was sold at a price totaling $1,234.80 made up of the addition of the time credit charges, insurance and tax to its cash price. Although the court clearly stated that there was no reason to doubt that § 2-302 was intended to encompass a price term and that no other provision of an agreement intimately touched upon the question of unconscionability than did the term regarding price, it was also clear that in the court's view unconscionability did not stem from the price disparity *per se* but also from the advantage-taking. In the court's words, "the value disparity itself leads inevitably to the felt conclusion that *knowing advantage was taken of the plaintiffs*".[121] It is also noted that the court in *Star Credit* cited *Lefkowitz* v. *ITM*,[122] *Frostifresh Corp.* v. *Reynoso*[123] and *American Home Improvement, Inc.* v. *MacIver*[124] in support of the view that § 2-302 encompassed a price term. The truth is that in none of these cases unconscionability rested upon price disparity alone. In effect, we have earlier discussed *Reynoso* and *American Home Improvement*.[125] As regards *Lefkowitz*, the prices in retail instalment contracts, charged

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[119] See *Remco Enterprise, Inc.* v. *Houston* (1984) 671 P.2d 567; *Toker* v. *Westerman* (1970) 274 A.2d 78; *Star Credit Corporation* v. *Molina* (1969) 298 N.Y.S.2d 570, discussed at footnote 114, *supra*.

[120] (1969) 298 N.Y.S.2d 264.

[121] *ibid.*, at 267 (italics added). However, it must be said here that although it is correct to attack price disparity on the ground of advantage-taking and not of disparity *per se*, it is erroneous to vindicate conclusive evidence of advantage-taking from price disparity alone, for this will result in such circularity as previously explained. An actual examination of facts of the case must be needed.

[122] (1966) 275 N.Y.S.2d 303.

[123] (1966) 274 N.Y.S.2d 757.

[124] (1964) 201 A.2d 886.

[125] See respectively footnote 114 and p. 237, *supra*.

2-6 times the cost per unit to sellers, were in fact held unconscionable by reason of fraudulent statements and conduct of the sellers. The buyers were told that the price of the product would be paid not out of their own pockets but out of commissions under a "referral-sale program" contained in a separate commission agreement (under which an agreed amount would be paid to the buyer for each sale resulting from the submission of names of potential customers or referral by that customer to the seller) and that the retail instalment contract was only a formality and only necessary to ensure the payment of commissions. In addition, the seller misrepresented that in general cases when the price was paid from the commissions the buyer would still make a profit, although in most cases customers did not earn enough commissions to pay in full for the product. It also appeared that after retail instalment contracts had been made, the seller immediately delivered the products to the buyers and those contracts were immediately sold to finance companies who obviously were not even bound by the commission agreements.

The second category accommodates such a case in which an excessive price was agreed by the contestant party as a result of his lack of knowledge or understanding of the full price of *the contract in question* itself notwithstanding the absence of such advantage-taking as in the first type. The terms of the contract may have set forth such complicated computation of the total charges as to prevent the contestant party from full understanding of the actual price. This is, in other words, tantamount to the case of inability to understand contract terms. Indeed, this situation occurred in *American Home Improvement, Inc.* v. *MacIver*.[126] This type of case may have coexisted with the former type.[127]

Without either advantage-taking or lack of knowledge, courts uphold the agreed prices and take the view that the party agreeing to an excessive price simply regards that price as worth the goods or services. Indeed, this view has been expressly

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[126] (1964) 201 A.2d 886, see p. 237, *supra*.

[127] See, for example, *Frostifresh Corporation* v. *Reynoso* (1966) 274 N.Y.S.2d 757 (discussed at footnote 114, *supra*).

addressed in *Zepp* v. *Mayor & Council of Athens*[128] in which non-resident purchasers of water from the City Council claimed unconscionability of the water rates which were 2.25 times the rates charged to resident purchasers. The Court of Appeals of Georgia held that such rates could not be challenged as unconscionable under the UCC when those residents were free to decline the service and entirely avoid the assessed fee. The court said: "If plaintiffs believe that the fees they are asked to pay for the benefit of the city's water are too high, their recourse is of an economic and political nature".[129] Likewise, in *Perdue* v. *Crocker NAT. Bank*[130] wherein depositors contended that the bank's charge of $6 for processing cheques drawn on checking accounts without sufficient funds was unconscionable when the actual cost incurred by the bank in processing such a cheque was approximately $0.30 (thereby producing a 2,000% profit), the court clearly stated that although a price term, like any other term, may be unconscionable, an allegation that the price exceeded cost or fair value, standing alone, did not state a cause of action. The court clarified that in addition to the price justification, decisions examined the "procedural aspects" of unconscionability. In the instant case, it was found that the contract terms authorising such charge appeared in print so small that many could not read and that the bank did not furnish the depositors with a copy of the relevant document.[131]

5. Abstraction in Judicial Reasoning

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[128] (1986) 348 S.E.2d 673.

[129] *Ibid.*, at 678.

[130] (1985) 702 P.2d 503 (Cal).

[131] *Ibid.*, at 512, 513.

See also *Central Budget Corp.* v. *Sanchez* (1967) 279 N.Y.S.2d 391 which concerned an automobile sales contract, the court, at 392, proclaimed: "excessively high prices *may* constitute unconscionable contractual provisions within the meaning of section 2-302 UCC [citation omitted] (italic added). But this is not a proclamation that an excessive price *per se* constitutes unconscionability. The court merely intended to say that the defendant buyers were entitled to present evidence showing procedural unconscionability and, therefore, the seller's motion for summary judgment should not be granted: see *ibid.*, at 393. Again, it is noted that amongst the cases cited by the court—*State of New York (by Lefkowitz)* v. *ITM*; *Williams* v. *Walker-Thomas Furniture Co.* and *American Home Improvement Inc.* v. *MacIver*—none of them concerned price disparity *per se*.

An undesirable feature of the unconscionability doctrine under § 2-302 is that this doctrine, instead of serving merely as a gap-filler for cases uncovered by traditional doctrines of contract law, also brings within its supervisory coverage those situations which should be dealt with by the existing common law and equity—in particular, the situations involving the advantage-taking of circumstances of weakness. As one can agree with Hillman, the application of unconscionability to such cases without reference to the common law (and equitable) doctrines causes confusion by increasing the level of abstraction in judicial reasoning. Here, he says:

> "A court using the current unconscionability approach may merely list many factors influencing its decision—e.g. age, status, intelligence, business sophistication, bargaining power, explanation (or lack thereof), and availability of alternative sources of supply—and then simply conclude that the contract is or is not unconscionable. The court need not make any effort to show which factors are essential, which are sufficient, and which are superfluous. Consequently, factors previously subsumed under appropriate common law categories simply may be lumped together without consideration of their weight and effect."[132]

This truism can be visualised in many cases and is buttressed by the fact that the courts who make the determination of unconsconability under § 2-302 are merely required to look at the "mélange" of various factors, without being required to "highlight the significant subcomponents of procedural unconscionability that are factors in their decisions or even rank the factors".[133] *Bank of Indiana, NAT. Ass'n* v. *Holyfield*,[134] which Hillman gives as an illustration, deserves quotation here. The lease of cows which provided that the lessee, a couple with a high school education, were obligated to continue making payments even if leased cows were destroyed through no fault of the lessees (and the casualty insurance on the cows was completely inadequate)

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[132] Hillman, *op. cit.*, (footnote 116, *supra*), at 19.

It is noted that some courts went too far when they applied § 2-302 to cases which should have been decided with reference to the law of misrepresentation: see *Lefkowitz* v. *ITM* (discussed at p. 241, *supra*). A question may be posited whether the courts in the future will possibly treat duress cases under the "oppression" rubric of this section as well.

[133] *Ibid.* See also McLaughlin, *op. cit.*, (footnote 118, *supra*), at 446.

[134] (1979) 476 F. Supp 104.

was held unconscionable. The court enumerated a combination of factors indicative of procedural unconscionability:[135]

> "Mr. and Mrs. Holyfield have limited business education... . Mr. Holyfield did not read the lease before he signed it,[136] and in fact there was no opportunity to do so at the time it was presented. The clauses in the lease were never explained to him... . Unquestionably, the plaintiff is in a superior bargaining position than the defendants, especially in the light of the unstable financial position the Holyfields were in when they executed this lease, and the lease was not presented to them as being negotiable in any of its terms, but rather on a "take-it-or-leave-it" basis. Finally, the Court is influenced by the somewhat *sub rosa* manner in which the plaintiff operated through its broker and his employee[137].... "

It is manifest from the passage above that the elements indicative of lack of knowledge, advantage-taking, inequality of bargaining power and, perhaps, undue influence were lumped together to constitute unconscionability without the court's consideration of their weight and effect. As Hillman observes, it is unclear whether the court would have reached the same decision if the Holyfields had been well-educated, or had read the lease or had had it explained to them, or had been in good financial condition, or had been allowed to negotiate terms of the lease.[138] Obviously, the "lumping" approach like this is prone to blur the real ground of decision.[139]

Likewise, in *Weaver* v. *American Oil Company*[140] which concerned the "hold-harmless" clause in a lease of a service station that had the effect of exculpating the

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[135] *Ibid.*, at 111.

[136] In the other part of the judgment, the court also said that this was not surprising in view of its length and complexity: see *ibid.*, at 106.

[137] By which the court referred to the fact that the Holyfields placed great confidence in the broker who assured them that this was a good lease and that they would be furnished field supervision of the cows, although they never were.

[138] Hillman, *op. cit.*, (footnote 116, *supra*), at 20.

[139] This may also help explain the lack of clarity in the judicial consideration of the adhesive character of a contract or "inequality of bargaining power", the issue which we have earlier discussed: see p. 224, *supra*. It is difficult to ascertain whether the courts, when they spoke of this factor, intended to hold the "take-it-or-leave-it" element or "inequality of bargaining power" as in itself sufficient to constitute procedural unconscionability. This is simply because in those cases this factor existed in combination with other factors and the courts lumped them together, without doing more.

[140] (1971) 276 N.E.2d 144.

lessor from liability for negligence and compelling the lessee to indemnify the lessor for any damage or loss incurred as a result of the lessor's negligence, the real ground of holding this clause unconscionable appeared limpid. The court first pinpointed factors which pointed to the lack of sophistication and knowledge—the lessee left high school after one and a half years and thus was not expected to understand the meaning of technical terms,[141] contract clauses were never explained to him,[142] the exculpatory clause was in fine print and contained no title heading which would have identified it as an indemnity clause.[143] However, the court then seemed to switch to challenge its execution on a take-it-or-leave-it basis and went on to state that the law was not so primitive that it sanctioned a bargaining in which one party unjustly took advantage of the economic necessities of the other. Also, in *Industralease Automated & Scientific Corp.* v. *R.M.E. Enterprises, Inc.*,[144] a lease of an incinerator was made by the owner of a picnic grove who needed the equipment for disposing, through nonpollutant burning, the rubbish on the premises during the season. This lease, though containing warranty disclaimers, still preserved the warranties if the lessor was the manufacturer of the equipment, which here was the case. The lessee was then visited by a representative of the manufacturer-lessor who told him that the lease he had signed earlier was "no good" and that a new lease had to be signed. The new lease contained an unqualified disclaimer of express and implied warranties. In holding the disclaimer unconscionable, the court noted the following facts: (1) that the lessee was told to sign the new lease to replace the previously signed contract for not clearly communicated reasons, (2) that the atmosphere of haste and pressure on the lessee was clearly pervasive and (3) that the lessee was, with the beginning of the season for the grove operation, clearly at disadvantage to bargain further. This is a mere conglomeration of various factors without clearly stating the real ground of unconscionability.[145]

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[141] *Ibid.*, at 145.

[142] *Ibid.*, at 146.

[143] *Ibid.*, at 147.

[144] (1977) 396 N.Y.S.2d 427.

[145] See also *Fairfield Lease Corp.* v. *Umberto* (1970) 7 UCC Serv 1181 (concerning a lease of a coffee machine to a trucking company, which gave the lessor the right to accelerate payment of all accrued

The confusion generated by the increasing level of abstraction in judicial reasoning can be appropriately avoided if the doctrine of unconscionability excludes cases which already fall within the operation of common law and equity. In particular, elements involving advantage-taking should be left to existing equitable rules, with the result that the statutory unconscionability should be invoked to deal only with situations involving the absence of meaningful choice when no element of advantage-taking is present. More specifically speaking, its application should be limited to the lack of knowledge or understanding. This argument, it should be clearly stressed, does not ignore the common fact that the type of an absence of meaningful choice which involves no element of advantage-taking may coexist with the type of an absence of meaningful choice which involves elements of advantage-taking. It is merely intended to suggest that, in such a case, the aggrieved party will have to resort to both equitable doctrines and the statutory unconscionability doctrine and that a court which decides the case will also have to state the real grounds of the decision—clearly stating which factors fall within equitable rules and which factors fall within the statutory doctrine. Treating cases which involve the advantage-taking and cases in which such an element is absent under separate rules enables the courts to give clear grounds of unconscionability in their judicial reasoning. As proposed in Chapter 1,[146] when the lack of knowledge or understanding is present in an oral agreement or in a contract made between two private individuals (non-business parties), the element of advantage-taking of such ignorance is rather obvious, so that the unfairness in contract provisions should be remedied under a different rule.

6. Protection of Businessmen

§ 2-302 does not exclude businessmen from its scope of application. The courts generally maintain that while it is true that the notion of unconscionability is most frequently employed to shield disadvantaged and uneducated consumers, business

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and unaccrued rent upon the lessee's failure to perform any term of the lease) in which the clause in question was held unconscionable because of the absence of understandable reading, superior knowledge of one and the weakness of the other, and the non-negotiability of the agreement.

[146] See pp. 62, 63, *supra*.

parties can, in some circumstances, be unfairly surprised[147] in the same fashion as in the consumer context as well.[148] However, in practice, the status as a merchant is likely to curtail an ultimate chance of success in the proof of an unfair surprise in terms of knowledge of the implications of contract clauses. The factual hearing may lead to the conclusion that merchants, with business experiences, have entered into the agreement with full knowledge and apprehension of all consequences so that risks and burdens assumed are voluntarily allocated and the contract is not unconscionable. For example, in *K & C, Inc.* v. *Westing House Electric Corp.*[149] where a corporate dry-cleaning establishment challenged exclusion of consequential damages clauses in a sale agreement with a manufacturer of dry-cleaning equipment, the court held it not unconscionable, stating that the buyer "was hardly the sheep company with wolves".[150] The court emphasised that[151] the buyer-company was owned by an experienced businessman and an attorney with 11 years' experience in the practice of the law. The similar view has been expressed in *Continental Airlines* v. *Goodyear Tire & Rubber Co.*[152]in which the court said: "It makes little sense in the context of two large, legally sophisticated companies to invoke the...unconscionability doctrine".[153]

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[147] As far as contracts between business parties are concerned, "oppression" is not mentioned in the argument at this stage because it has previously been concluded that the "oppression" rubric embraces cases involving advantage-taking which should be treated under a separate rule from the doctrine of unconscionability under § 2-302.

[148] See the statement in *Johnson* v. *Mobil Oil Corp.* (1976) 415 F. Supp 264.

[149] (1970) 263 A.2d 390.

[150] *Ibid.*, at 393.

[151] *Ibid.*, at 393.

[152] (1987) 819 F.2d 1519, at 1527.

[153] See also *Cryogenic Equipment, Inc.* v. *Southern Nitrogen, Inc.* (1974) 490 F.2d 696, at 699; *Wyatt Industries, Inc.* v. *Publicker Industries, Inc.* (1969) 420 F.2d 454, at 457; *Arkwright-Boston Mfrs. Mut. Ins. Co.* v. *Westinghouse Elec. Corp.* (1988) 844 F.2d 1174 ("no evidence that the buyer was either ignorant or inexperienced"); *Hydraform Prods. Corp.* v. *American Steel & Aluminum Corp.* (1985) 498 A.2d 339 (buyer's president was not an innocent in the industry); *Polygram, S.A.* v. *32-03 Enterprises, Inc.* (1988) 697 F. Supp 132, 8 UCC Rep Serv 2d 914 (buyer had extensive experience in dealing with the seller and had knowledge of the terms and conditions of the industry of compact discs, so that the 90-day return provision was not unconscionable).

It must be noted, however, that the exclusion of merchants from the protective operation of § 2-302 in such a case is not as a matter of law but as a matter of actual investigation into facts vindicating procedural unconscionability. In particular, subsection 2 of this provision requires the courts to consider "commercial setting" in making the determination of unconscionability. Indeed, the courts in some cases held contract clauses unconscionable even when the claimants were large corporations when the courts were satisfied that the claimants were unfairly surprised.[154] This is an inapt approach. As we have advocated in Chapter 1, sophisticated merchants, as contrasted with unsophisticated merchants, should be outright excluded from the operation of such a general doctrine as § 2-302 as a matter of law. When a trader trades with a sophisticated merchant, his (the former's) reasonable belief that the merchant has voluntarily assented to the contract provisions should be protected. The draftsmen of this unconscionable section might have overlooked the significance of this reliance foundation of the objective theory of contract.

Small or unsophisticated businessmen inarguably fall within the protective coverage of § 2-302. Indeed, the expression "the sheep company with wolves" which the court has addressed in *K & C, Inc.* v. *Westing House Electric Corp.* above is a colourable description of this class of merchants. Extending protection to this type of business parties is an admirable attribute of this unconscionability doctrine, for their position might be too suspect to attract a reasonable reliance. As far as case law is concerned, many transactions made with unsophisticated businessmen have been held unconscionable. Amongst those who claimed unconscionability are: commercial farmers,[155] husband and wife who bought a "food plan" (refrigerator and food to keep in it) for their family-run business,[156] a couple who leased cows for their dairy farming

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[154] *Trinkle* v. *Schumacher Co.*; (1980) 301 N.W.2d 255; *Construction Associates, Inc.* v. *Fargo Water Equipment Co.* (1989) 446 N.W.2d 237, 10 UCC Rep Serv 2d 821.

[155] *A & M Produce Co.* v. *FMC Corp.* (1982) 186 Cal. Rptr. 114; *Martin* v. *Joseph Harris Co., Inc.* 767 F. 2d 296.

[156] Star *Credit Corporation* v. *Molina* (1969) 298 N.Y.S.2d 570.

operation,[157] a gas station operator.[158] A striking illustration is *A & M Produce Co.* v. *FMC Corp.*[159] wherein a farming company claimed unconscionability of a disclaimer of warranties and an exclusion of consequential damages in a contract for sale of a weight-sizing machine. The court has addressed that although businessmen have generally been viewed as possessing a greater degree of commercial understanding and usually have a more difficult time establishing "unfair surprise", generalisations are always subject to exceptions and categorisation is rarely an adequate substitute for analysis. "Courts", the court further explained, "have begun to recognize that experienced but *legally unsophisticated* businessmen may be unfairly surprised by unconscionable terms".[160] Against this background, the clause in question was held unconscionable. This decision has been criticised[161] as generally aiding businessmen *vis-à-vis* unconscionability. However, this criticism is not to do justice to the court in this case. In truth, the court merely drew the distinction between sophisticated and unsophisticated businessmen and implored the treatment of the latter as general consumers or laypersons. The peculiar facts of this case support the classifying of this businessman-plaintiff as an unsophisticated merchant. The plaintiff company was solely owned by a layperson who had been farming all of his life and employed only five persons on a regular basis and up to fifty persons at harvest time.

VI: CONCLUSION

The American doctrine of unconscionability in § 2-302 of the Uniform Commercial Code is at the forefront in the sphere of protecting contracting parties against unfair terms in contracts. Although it has been the subject of criticism since the time when the Code came into force, this provision has consistently played a pivotal

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[157] *Bank of Indiana, NAT. Ass'n* v. *Holyfield* (1979) 476 F. Supp 104 ("they [the couple] are far from being sophisticated business persons").

[158] *Weaver* v. *American Oil Company* (1972) 276 N.E.2d 144 (Supreme Court of Indiana); *Johnson* v. *Mobil Oil Corp.* (1976) 415 F. Supp 264.

[159] (1982) 186 Cal. Rptr. 114.

[160] *Ibid.*, at 124 (italic added).

[161] See, for example, Sargent, *op. cit.*, (footnote 65, *supra*).

supervisory role in the United States. Its objection by some legal scholars[162] cannot be squared with its total inaptitude. We have demonstrated that the analytical framework applied in this doctrine is meritorious in many respects in spite of some demerits which are yet to be put right. Case law has been built up around the doctrine over the period of more than thirty years. In particular, many criteria for assessing unconscionability have been articulated by the judiciary. It is submitted that this empirical development can be of particular value to the English legislature in the light of the reform of English law in this area. It will be demonstrated in the next chapter that, following the recent implementation of the EC Directive on Unfair Terms in Consumer Contracts, England has now introduced a general rule for the control of contractual terms. We point out in that chapter that some inappropriate features are found in the framework of control. To amend that blemish, the meritorious sides of the American parallel rule can certainly be taken heed of.

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[162] See, for example, Epstein, "*Unconscionability: A Critical Reappraisal*", (1975) 18 J. Law and Econs 295. We have already discussed his views in Chapter 1.

CHAPTER 5

EC DIRECTIVE ON UNFAIR TERMS IN CONSUMER CONTRACTS

I: INTRODUCTION:

The issue relating to the control of unfair terms in contracts has long been seized upon by the European Communities[1] and the movements towards the harmonisation of laws in Member States in this matter have now culminated in the EC Directive on Unfair Terms in Consumer Contracts (hereinafter called the "Directive") which was adopted by the Council of the Communities on 5 April 1993[2] and requires its implementation by the laws, regulations and administrative provisions of Member States no later than 31 December 1994.[3] Certainly, this implementation date has elapsed and, in consequence, the Directive has substantial impacts on the laws of contract of member states including the United Kingdom. Given that the application of the Directive, as will be shown below, is not limited to the context of exclusion clauses as is the case under the Unfair Contract Terms Act 1977 (hereinafter called "UCTA"), it is to a large extent characteristic of "the general rule" in as much the same sense as proposed throughout this thesis. This, therefore, provides this thesis with a special opportunity for criticisms and commentary to be addressed in this Chapter.

In the United Kingdom, the Directive has been implemented by the Unfair Terms in Consumer Contracts Regulations 1994[4] (hereinafter referred to as the "Regulations") which are made by the Secretary of State of Trade and Industry by virtue of the power conferred upon him by section 2(2) of the European Communities

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[1] Although the formerly "European Communities" have recently been officially renamed as the "European Union", the citation by this thesis will be based on its former name—the "European Communities", given that the latter is more cited in a political sense. It is also noted that the Directive was adopted by the Council before the alteration of the Communities's official name.

[2] The Council is empowered by Article 100A of the EEC Treaty to adopt measures intended to establish and function the internal market.

[3] This Directive is published in O.J. EC L 95/29, 21.4.93.

[4] S.I. 1994/3159

Act 1972.[5] The Regulations are prescribed to come into force on 1 July 1995. Again, this date has elapsed and contracts made thereafter will be subjected to the Regulations. The problem arises, however, in regard to the contracts made prior to the Regulations coming into force but after the date on which the Directive is required to be implemented by member states (namely, 31 December 1994). Although we are aware of the controversial submission that a Directive of the European Union may have a direct effect on the law of a member state even in the absence of a domestic law implementing it provided that the required implementation date has elapsed,[6] this thesis is not particularly concerned with this issue and, thus, criticisms and commentary in this Chapter will be addressed on the assumption that the Directive is now part of the English law of contract.[7] The paramount objective of this Chapter is to examine whether the framework employed by the Directive's framers is sustainable and consistent with the general framework adumbrated by this thesis or needs any suitable amendment. Also, given that the wordings of the Regulations are in line with the Directive, reference will be made to the provisions of the Directive although citation will, in most cases, be made of the corresponding provisions of the Regulations for the purpose of comparison.[8]

II: HISTORICAL BACKGROUND

Recital 8 of the preamble of the Directive reveals that the Directive has been enacted in response to the two Community programmes for a consumer protection and

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[5] Apparently, the decision to implement the Directive by means of subordinate legislation rather than individual statute was due to the time-consuming nature of parliamentary procedures coupled with the pressure in relation to the time-scale for implementation of the Directive.

[6] It is also possible that an individual may bring an action against the State for damages for the loss suffered as a result of the State's failure to implement the Directive on time, namely, as a result of the incorporation by a seller or supplier of any term which would have been non-binding on him if the Directive had been implemented on time. For the European Court's decision establishing the possibility of this action, see, for example, *Francovich* v. *Italian State* [1991] E.C.R. I-5357.

[7] The view that the Directive on Unfair Terms in Consumer Contracts has no direct effect without implementation by domestic law has been found in "*E.C. Directive on Unfair Terms in Consumer Contracts*" (Contributed Article), (1993) 10 Trading Law 154.

[8] Unless otherwise stated, reference of the provisions in the Directive and the Regulations will be made by using the citations (on the numeric basis) "Article" and "Regulation" respectively.

information policy—the preliminary programme of 14 April 1975[9] and the second programme of 19 May 1981[10] (hereinafter called the "Preliminary Programme" and the "Second Programme" respectively). Briefly speaking, Article 2 of the Treaty establishing the EEC requires as one of its tasks the improvement of the standard of living. This task entails the consumer protection and information policy to be implemented within the Community and has then culminated in the aforementioned programmes. The Preliminary Programme, having stated that change in and abuse of market conditions (including mergers, cartels and certain self-imposed restrictions on competition) have created imbalances to the detriment of consumers,[11] includes in the clearly enumerated five basic rights of consumers "the right to protection of economic interests.[12] It further states that greater substance of this right should be given both by specific Community Policies and by the approximation of laws.[13] The Second Programme was launched merely to bring the Preliminary Programme up to date and to ensure the continuity of the measures then taken or to be taken.[14] The enactment of the Directive on Unfair Terms in Consumer Contracts is, therefore, intended to approximate the laws in the matter of unfair terms in contracts in order to protect consumers' economic interests arising from contract making.[15] This purpose is also clearly stated in Article 1(1). The work on the Directive was commenced before 1981. The Second Programme spoke of the early movements at the Commission level as follows:[16]

> "The Commission has already started work on unfair terms in contracts, with the help of government experts, as a basis for a Community measure. Meanwhile, legislation has been adopted in several Members State, and the Commission will submit, as a first step, a discussion paper in which it will set

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[9] O.J. No. C 92/1, 25.4.75.

[10] O.J. No. C 133/1, 3.6.81.

[11] See cls. 6, 14.

[12] See cl. 3.

[13] See cls. 4. See also cl. 24, 25.

[14] See cls 1, 2, 3.

[15] For the general protection of consumers' economic interests within the Community, see Norbert Reich, "*Protection of Consumers' Economic Interests by the EC*", (1992) 14 Syd. L.R. 23.

[16] See cl. 30, para 2.

> out all the problems which this subject involves and the various options open with a view to harmonizing those aspects of competition which may be affected by disparities in this area. After wide-ranging consultations on this discussion paper, the Commission will put forward suitable proposals, where necessary."[17]

III. SCOPE OF APPLICATION

1. Application to "Consumer"

As its title indicates (and as explicable on its close connection with the consumer protection movements hitherto discussed in the preceding section), the Directive applies only to consumer contracts by providing that unfair terms contained in a contract concluded "with a 'consumer'[18] by a seller or supplier" shall not be binding on the consumer although the contract shall continue to bind the parties upon other terms if it is capable of continuing in existence without the unfair terms.[19] It might be said that the Directive is of a narrower application than UCTA since UCTA's key section—section 3—also extends its protection to businessmen if the contract is

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[17] In effect, apart from the two Programmes above, the Commission also presented to the Council another document (Communication to the Council of 4 July 1985) entitled "The Need for a New Impetus for Consumer Protection Policy", published in Bull. EC Supp. 6/86. Although this Policy (hereinafter called "The New Impetus") is primarily intended to set out objectives and priorities of measures concerning product quality and safety, it is found that the matter of unfair terms in contracts has been mentioned in two clauses: clause 8 (addressing that consumers want safe and healthy products to move freely and sold on fair terms) and Clause 30 (speaking of consumers having to deal with standard form contracts and requiring protection against unfair terms). The Council passed a Resolution of 23 June 1986 welcoming The New Impetus and inviting the Commission to draw up and submit proposals for legislation harmonisation (which, of course, included the proposed directive on unfair terms in contracts): see O.J. No. C167/1, 5.7.86 and EC Bull. Supp. 6/86 above.

For more details on the development of the draft directive on unfair terms in consumer contracts, see the Commission's Explanatory Memorandum to the draft submitted to the Council (hereinafter called the "Explanatory Memorandum") reproduced in Annex 3 to the Sixth Report of the House of Lords Select Committee on the European Communities (Session 1991-92) H.L. Paper 28, p. 39 (hereinafter called the "Sixth Report").

[18] The Directive defines "consumer" as "any natural person who, in contracts covered by this Directive, is acting for purposes which are outside his trade, business or profession". See also the corresponding definition in Regulation 2(1). As rightly brought out by Lawson, the literal reading of this definition may lead to the bizarre conclusion that a person can only be a consumer if he has a business of his own. Obviously, this anomaly is prompted by the slip of the pen. The phrase "outside *his* trade, business or profession" above has, in reality, been intended to convey "outside such trade, business or profession, if any, as he might have": see Richard Lawson, *Exclusion Clauses and Unfair Terms*, 4th edn., (FT Law & Tax, 1995), p. 159.

[19] Article 6 and Regulation 5. The qualification that the remaining terms can stand is apparently reminiscent of the traditional doctrine of "severance".

concluded on the written standard terms.[20] Nevertheless, the Directive's limited application in this sense is not an undesirable character since, as this thesis has proposed in Chapter 1, businessmen should not be afforded protection unless they are small businessmen or, in other words, belong to the unsophisticated class of businessmen. (In this connection, it will be demonstrated below this class of businessmen may, *in some circumstances*, receive the protection under the Directive as well.) In any event, the Directive can be said to have a broader application than UCTA since it is not restricted to exclusion clauses but, rather, applies to *all* terms in *all* contracts[21] (provided, however, that those terms have not been individually negotiated, as will be explained in due course).

As previously mentioned, a consumer is entitled to make his "unfair term" claim only when he has made the contract with a "seller or supplier" which, based on the definition provided for by the Directive, means any person (including legal persons) who is acting for purposes "*relating to*"[22] his trade, business or profession, whether publicly or privately owned.[23] It is thus evident that a contract reached between two consumers (or, more precisely speaking, between two private individuals neither of whom is carrying out any business) is not subject to scrutiny *vis-à-vis* unfairness. As with the case of UCTA, the exclusion of a contract concluded in this setting from the operation of the Directive may have stemmed from the impression that the likelihood of unfair terms being applied is not great in this very instance. In this regard, it should be reiterated here that this thesis maintains that apart from the slender likelihood above

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[20] See Chapter 3, *supra*.

[21] The English Regulations, by Schedule 1 thereto, exclude the following contracts from their application: contract relating to employment; contract relating to succession rights; contract relating to rights under family law; contract relating to the incorporation and organisation of companies or partnerships. This exclusion is found in recital 10 of the preamble of the Directive although it is surprisingly not contained in any of its individual Articles. Article 1 of the Directive merely exempts from its application contractual terms which reflect *either* mandatory (statutory or regulatory) provisions *or* the provisions or principles of international conventions to which the Member States or the Community are party. (Recital 13 of the preamble amplifies that mandatory provisions are assumed not to contain unfair terms.) This disapplication is implemented by paragraph (e) of the said Schedule to the Regulations.

[22] For the significance of this emphasis, see the following paragraph of the text.

[23] Article 2(c), Regulation 2(1).

the justification for disapplying any general rule allowing judicial scrutiny to this type of contract should also lie in the fact that the element of advantage-taking is generally found there and thus relief should be given under a separate rule for the sake of avoiding confusion caused by the increasing level of abstraction in judicial reasoning.

One interesting point should be noted. The definition of "seller or supplier" under the Directive does not state that the seller must "sell" the goods or supplier "supply" services. Mere "acting for the purposes '*relating to*' his trade, business or profession" is sufficient to bring the trader to be the "seller or supplier" under the Directive. Whatever the real intention of the framers was, the wording as it appears can be discerned as resulting in intellectual refinement. The terminology "seller" or "supplier" can nicely be taken to embrace traders who "deal with" goods or services. On this basis, it follows that the reverse situation in which a consumer sells the goods or supplies services to the firm will also be covered by the Directive, with the result that this consumer is entitled to claim that a contract term offered by the firm is unfair. This appears to be praiseworthy since hardship caused to consumers is not restricted to the scenario in which consumers buy goods or receive services from traders.[24] This contingency unfortunately seems to be beyond the contemplation of the draftsmen of the Regulations. The Regulations define "seller" as a person who "*sells* goods ... and who is acting for the purposes relating to his business" and, likewise, "supplier" as a person who "*supplies* goods or services ... and who is acting for the purposes relating to his business". Such being the case, it is proposed, as a temporary solution to this deficiency, that a consumer who sells or supplies goods or services to a trader may also be treated under the Regulations as making a contract with a seller or supplier if that trader buys those goods or obtains those services for the purpose of resale or resupply. This treatment rests upon the assumption that the definitions in the Regulations above do not require the act of "selling" or "supplying" on the part of traders to take place in the particular contract in which an unfair term is invoked by the

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[24] See *Campbell Soup Co.* v. *Wentz* (1948) 172 F.2d 80 (discussed at p. 270, *infra*) for an illustration of this scenario. In this case, a soup company bought carrots from unsophisticated commercial farmers. We are aware that this type of contract does not fall within the current scope of application of the Directive. However, we propose that this type of businessman should be treated as consumer: see the discussions in the following paragraph of the text. The mention of *Campbell Soup* here is merely intended to spell out that a trader can behave unfairly in the capacity as buyer as well as in the capacity as seller.

litigant consumer. Mere normal engaging in selling or supplying goods or services suffices. This point seems to remain unnoticed by commentators.

2. Businessmen

As the term "consumer" is defined as "any natural person who is...acting for purposes which are *outside his trade, business or profession*",[25] large corporations outright fall outside the ambit of the Directive; and, again, this account is believed by this thesis to be justifiable. It is noted that even the authority in *Rasbora Ltd.* v. *J.C.L. Marine*[26] and *R & B Customs Brokers Co. Ltd.* v. *United Dominions Trust Ltd.*[27] (which holds that a firm can be regarded as a consumer when it contracts with another body corporate if the goods transacted are intended for the use of its members and not for resale, or, if the transaction is merely incidental to, rather than forming an integral part of, the business carried on provided that such transaction is not conducted with some degree of *regularity*) is not of assistance to this category of businessmen as long as they are legal (juridical) persons.

The implication of the Directive on unfair contractual disadvantages which might be allegedly suffered by those categorised as small or unsophisticated businessmen remains to be considered. On analysis, the Directive can be interpreted as also capable of affording them merely *partial* protection. It should, first, be recalled that the Directive defines a consumer as a *natural person* contracting for purposes which are *outside his trade or business*. Undoubtedly, in many cases, traders may prefer to establish their business in a non-corporate form. Inevitably, there are various situations in which such an entrepreneur needs to deal with other traders in the transactions which are only incidental to his business in the sense as once perceived by English courts in *Rasbora Ltd.* v. *J.C.L. Marine* or *R & B Customs Brokers Co. Ltd.* v. *United Dominions Trust Ltd.* above. A commercial farmer, for instance, has to buy

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[25] Article 2(b), Regulation 2(1).

[26] [1977] 1 Lloyd's Rep. 645. Again, although this is a case on section 55(7) of the Sale of Goods Act 1893, the decision on the issue as to whether the sale in question was a consumer sale or non-consumer sale undoubtedly bears direct relevance to the determination as regards a business dealing or a consumer dealing under UCTA.

[27] [1988] 1 W.L.R. 321, discussed in Chapter 3, *supra*.

agricultural equipment and fertilizers for his farm. If this "incidental" transaction is perceived of as falling "outside his trade or business" in accordance with the definition of the Directive, the Directive protects small businessmen in this sense; and in which case this protection appears wider than that afforded by the case law above since the "regularity" requirement is not found in the provisions of the Directive. It would follow, therefore, that a commercial farmer who purchases fertilizers on the regular basis from the manufacturer or dealer is treated as a consumer and thus protected from unfair terms. (However, all this expostulation may be speculative since it is not known at this stage whether the European Court of Justice will in the future introduce a contrary interpretation—that such an incidental transaction is carried on "inside" the business. If this is the case, the English judiciary will be obliged to adopt the same line and the Directive will totally exclude businessmen, whether sophisticated or unsophisticated class.)

Next, in any event, a small businessperson is placed outside the Directive's scope of application when he enters into a transaction which forms an integral part of his business. A single trader who buys goods for resale in his family-run grocery is apparently unable to challenge that any of the contracts relating to those goods contains unfair terms. In this respect, the Directive is still insufficient.

Furthermore, the insufficiency of the Directive's scope of protection *vis-à-vis* small businessmen can also be found in that, given that the definition of "consumer" merely embraces a *natural person*, a small businessman who carries on business set up in the entity of a body corporate is absolutely cast out whether the transaction in relation to which he purports to contest unfair terms constitutes an integral part or merely appears incidental to the business. Indeed, the establishment by a small businessman of a business in a form to which the law ascribes the separate corporate personality is not uncommon. A family-run small company, as in the leading case of *Salomon* v. *A. Salomon & Co. Ltd.*,[28] is often vulnerable to hardship arising from

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[28] [1987] A.C. 22 (H.L.).

contracts made with large corporations. It is of little sense to exclude unsophisticated body corporate from the safeguard under the Directive.[29]

3. Terms "Not Individually Negotiated": Focus Upon Standard-Form Contracts

Although the Directive applies to contractual terms in general and is not limited to exclusion clauses, its application is limited to "contractual terms which have not been individually negotiated".[30] Obviously, this expression depicts terms contained in an "adhesion" contract, for which the seller or supplier has unilaterally set the contents without giving the consumer the opportunity to negotiate for change or to co-determine the terms. Article 3(2) expressly provides:[31]

> "A term shall always be regarded as not individually negotiated where it has been drafted in advance and the consumer has therefore not been able to influence the substance of the term, *particularly in the context of a pre-formulated standard contract*". (Italics Added)

Undoubtedly, an adhesion contract is not necessarily contained in a standard form and can possibly be embodied in a simple written but not standardised document or, in rare cases, can be merely verbal. The Directive takes account of this truism and thus section 3 above applies "*particularly*", not in any way "*exclusively*", to standard-form contracts.[32] Indeed, it has been clearly specified in its eleventh preambular

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[29] *Cf.* the German concept. Although §§ 10 and 11 of the Standard Contract Terms Act 1976 are not applicable to a merchant dealing in the course of his business, a person who carries on small-scale business (e.g. a shopkeeper) is not regarded under the Commercial Code as a merchant: see Wolfgang Freiherr von Marschall, "*The New German Law on Standard Contract Terms*", [1979] L.M.C.L.Q. 278, at 283.

Some commentators (for example, Ewoud Hondius, "*EC Directive on Unfair Terms in Consumer Contracts: Towards a European Law of Contract*", (1994) 7 J.C.L. 34 at 36) have argued that the Directive should be amended in the near future to be of general application to consumers and businessmen alike since the existence of unfair terms is not restricted to consumer contracts. Indeed, the Legal Affairs Committee of the European Parliament was of the same view: see the "Explanatory Memorandum" in the "Sixth Report", *op. cit.*, (footnote 17, *supra*), p. 39. This is an "over-protective" account. Rather, the extension of the Directive's scope of application to businessmen should be confined to the unsophisticated class.

[30] Article 3(1) and Regulation 3(1).

[31] See also the corresponding Regulation 3(3).

[32] Roger Brownsword and Geraint Howells, in "*The Implementation of the EC Directive on Unfair Terms in Consumer Contracts—Some Unresolved Questions*" [1995] J.B.L 243 at 246, assert that although the reference to pre-formulated standard contracts is no more than one example of where non-individually negotiated terms might appear, the word "particularly" in Article 3(2) adds nothing and is redundant. This view, with respect, seems self-contradictory.

paragraph that "the consumer must receive equal protection under contracts concluded by word of mouth and written contracts regardless, in the latter case, of whether the terms of the contract are contained in one or more documents."[33] On this point, this thesis must, again, hold that although the protection should apply to standardised and non-standardised contracts alike, it should not extend to verbal contracts for the reason previously addressed in Chapter 1.[34]

As earlier mentioned, although the Directive's application is not limited to standard-form contracts, its focus is obviously placed upon such an agreement, as is manifest from the expression "particularly in the context of a pre-formulated standard contract" above.[35] It is noted that the Regulations do not contain this reiterative phrase. This omission is, however, immaterial since such emphasis is self-inferred, given that most consumer contracts are in the form of standard pads and that unfair terms are consequently found in such a contract.[36]

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[33] A useful discussion on the issue as to whether the preamble is admissible to clarify or even qualify the text of Community legislation itself can be found in Peter Duffy, "*Unfair Contract Terms and the Draft E.C. Directive*", [1993] J.B.L. 67 at 71, 72.

[34] Some have argue that the Directive should also apply to such an oral contract as in the case in which a hotelier verbally contracts with a guest incorporating the terms in a notice displayed at the reception desk: see Geraint Howells, *Consumer Contract Legislation*, (Blackstone Press, 1995), p. 38. Obviously, this connotes a notice which has a contractual effect rather than one without such effect. However, this situation should be regarded as a 'written' contract and the best solution seems to be by way of a definition that a written contract shall include an oral contract which is made subject to written conditions.

[35] See also the mention by the Commission of standard form contracts in *The New Impetus*, *op. cit.*, (footnote 17, *supra*), cl. 30.

[36] In addition, this inference can be drawn from the reading of Regulation 3(3) in conjunction with Regulation 3(4): "Notwithstanding that a specific term or certain aspects of it in a contract have been individually negotiated, these Regulations shall apply to the rest of a contract if an overall assessment of the contract indicates that it is a pre-formulated standard contract" (discussed in the following paragraph of the text). However, this may, on the other hand, present an inadvertent problem. The omission in Regulation 3(3) of the phrase "particularly in the context of a pre-formulated standard contract" might be construed in conjunction with Regulation 3(4) as meaning that the Regulations apply merely to standard-form contracts. Until the Regulations are officially altered to be in harmony with the Directive in this respect, a manipulative interpretation technique is, it is submitted, available for English courts to achieve the Community's purpose.

To prevent sellers or suppliers from evading the operation of the Directive by creating a false appearance of an individual negotiation of a contract,[37] the Directive has made it clear that the mere fact that certain aspects of a term or one specific term have been individually negotiated shall not preclude the scrutiny of unfair terms if it is evident from an overall assessment of the contract that "it is a pre-formulated standard contract".[38] A criticism can, however, be addressed that the wording employed here seems to be the slip of the pen. As a written but not standardised contract can be an adhesion contract as well, this instrumental provision should apply with equal force to such a contract. Thus, the phrase "it is a pre-formulated standard contract" above should be replaced by "it is a pre-formulated contract".

As we have analysed in Chapter 1, as far as adhesion (particularly standard-form) contracts are concerned, the justifiable ground for allowing scrutiny of unfairness lies in the lack of knowledge or understanding of their terms rather than their use or their adhesive feature. Although this problem was seen to be contemplated by the framers of the Directive,[39] it seems that greater emphasis was placed on the facts that the *proferens* possess a stronger bargaining power and consumers are not given an opportunity to co-determine or alter the terms offered on this take-it-or-leave-it basis. The framers appeared to discern sellers or suppliers in this situation as abusive. Much evidence indicates all this perception. First, the Commission once addressed in its communication presented to the Council on 14 February that standard terms resulted in an unfair or inequitable imbalance in favour of the supplier because they were designed, drawn up and applied unilaterally by the supplier and thus improved his bargaining power.[40] Secondly, recital 9 of the preamble of the Directive states, referring to the "Protection of the economic interests of the consumers" in the Consumer Protection and Information Policy Programmes, as follows: "acquirers of

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[37] *Cf.* attempts to evade the operation of the Unfair Contract Terms Act 1977 by recasting contract terms to look like non-exclusion clauses, discussed in Chapter 3, *supra.*

[38] Article 3(3), Regulation 3(4).

[39] See p. 266, *infra.*

[40] See Bull. E.C. 1984 Supp. 1/84, (consultation paper entitled "*Unfair Terms in Contracts Concluded with Consumers*"), paras 13, 14.

goods and services should be protected against the *abuse of power* by the seller or supplier, in particular against one-sided standard contracts and the unfair exclusion of essential rights in contracts".[41] Thirdly, the "strength of bargaining positions" has specifically been introduced to be a particular criterion for determining "good faith", the procedural echelon of "unfairness" under the Directive which will be dealt with shortly. The "abusive"-related perception should be put right so that a consumer will not be allowed to contest a contract term as being unfair if he has entered into the contract with full knowledge and understanding of it. This argument will become more crystallised when procedural unfairness under the Directive is explained.

There has emerged an argument that consumer interests will be disappointed when the Directive does not deal with individually negotiated terms.[42] In other words, it is argued that consumers should be protected against unfair terms in non-adhesion contracts as well. This seems to be an overstatement. Obviously, a contract which is concluded in the setting in which both parties privately co-determine the terms and conditions will not generally present ignorance problems.[43] Considered in this light, the disapplicability of the Directive to this type of contract should not be regarded as an ill-success. This contention is not in any way to ignore the situation in which although the consumer is given full freedom to argue over terms presented by the trader the consumer's inability to understand the pre-drafted terms prevents him from a practical negotiation. Nevertheless, a contract in such a scenario can be taken as not an individually negotiated contract under the relevant provision of the Directive. Indeed, the wording "*able* to influence the substance of the term" as appears in Article 3(2) (and the corresponding Regulation 3(3))[44] makes such a manipulative interpretation possible. That is to say, the word "ability" should be taken as conveying real rather than apparent ability.

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[41] Italics added.

[42] See Hondius, *op. cit.*, (footnote 29, *supra*), at 35.

[43] A similar view is presented by Hugh Collins in "*Good Faith in European Contract Law*", (1994) 14 O.J.L.S. 229 at 239.

[44] See the quotation at p. 259, *supra*.

IV: TYPES OF UNFAIRNESS REQUIRED

As with the American doctrine of unconscionability under U.C.C. § 2-302 which we have already examined at considerable length in the preceding chapter of this thesis, the Directive requires both procedural and substantive unfairness to be established before a particular contract term can be destructible as unfair in favour of a consumer. This core concept is encapsulated in Article 3: "A contractual term...shall be regarded as unfair if, contrary to the requirement of good faith, it causes a significant imbalance in the parties' rights and obligations arising under the contract, to the detriment of the consumer".[45] Obviously, the factors constituting procedural unfairness are lumped up under the "good faith" locution whereas the "significant imbalance to the detriment of the consumer" is the language descriptive of substantive unfairness. Both expressions give rise to criticisms as to their determinable skeletons. This will be now discussed.[46]

1. Procedural Unfairness: The Requirement of "Good Faith"

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[45] See Regulation 4(1)

[46] Some interpret the "good faith" requirement in the Directive as descriptive of the unfair substance of the contract term in the sense that if a term causes a significant imbalance to the detriment of the consumer the term is automatically contrary to "good faith". This interpretation, that is, suggests that no distinction between procedural and substantive unfairness is intended by the Directive. See, for example, Elizabeth Macdonald, "*The Directive on Unfair Terms in Consumer Contracts*" (1993) 10 Trading Law 194 at 196, where she merges the "good faith" requirement and the "significance imbalance" element under the "imbalance test" which she regards to be the general test of fairness in the Directive in contrast to the "unreasonableness test" under UCTA. Such a reading is, however, far from clear. Had mere significant imbalance been intended, it would have been so stated without redundant reference to "good faith". More importantly, it will be seen below that the factors stated by the Directive to be taken into account in assessing "good faith" are directed at "procedure". For those who also discern the test of fairness under the Directive as a dual procedural and substantive test, see Brownsword and Howells, *op. cit.*, (footnote 32, *supra*), at 252-254, Howells, *op. cit.*, (footnote 34, *supra*), pp. 41-42, and Lawson, *op. cit.*, (footnote 18, *supra*), p. 163 (see in particular his example at p. 168).

In this connection, Hugh Collins, in *op. cit.* (footnote 43, *supra*) at 250, asserts: "The Directive does not state that the significant imbalance ... must be caused by actions contrary to the requirement of good faith, as one would expect if the requirement of good faith referred solely to procedural matters such as pressure and deception." However, Collins merely means that it would be wrong to confine "good faith" to defects in negotiating procedures which are already addressed through the doctrines of misrepresentation, duress, and undue influence. Indeed, Collins explains that the requirement of "good faith" could be interpreted as remedying market failure, ranging from deceptive trading practices during the negotiations to the drafting of standard form contracts.

A term which causes a consumer a significant imbalance in the rights and obligations under the contract to his detriment must have been entered into contrary to the requirement of "good faith" if it is to be regarded as unfair. Since the Directive expressly stipulates that "unfairness" must be determined by reference to circumstances at the time of conclusion of the contract, "good faith" as required here necessarily augurs "good faith" in the formation rather than good faith in the performance of the contract.[47] This consideration elucidates the placement of the requisite procedural unfairness under the "good faith" locution. No elaboration upon the substance of "good faith" has been made in any Article of the Directive. However, its preamble, in recital 16, contains the statement concerning the assessment of this element. The reason for the inclusion of such a statement in the preamble rather than in the main provisions of the Directive remains mysterious. The English draftsmanship, in the Regulations, appears more systematic on this point when it clearly provides that particular matters for the determination of the requirement of good faith are specified in Schedule 2;[48] those matters are, in the main, identical to the statement in recital 16 of the preamble above, which are as follows:

(a) the strength of the bargaining positions of the parties;

(b) whether the consumer had an inducement to agree to the term;

(c) whether the goods or services were sold or supplied to the special order of the consumer;

(d) the extent to which the seller or supplier has dealt fairly and equitably with the consumer (taking into account the consumer's legitimate interest).

Notably, the first three factors—items (a), (b), (c)—are not new to English law; they are indeed reminiscent of the items (a), (b) and (e) contained in Schedule 2 to UCTA 1977 which we have discussed in Chapter 3. Such being the case, the criticisms and commentary previously addressed in that Chapter in relation to these criteria are therefore applicable here in *pari materia*.

1.1 Strength of Bargaining Positions

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[47] For "good faith" in the performance, see, for example, the American Restatement (Second) of Contract § 205: "Every Contract imposes upon each party a duty of good faith and fair dealing in its performance and its enforcement".

[48] Regulation 4(3).

It has been reiterated in this thesis on various occasions that if the expression "strength of bargaining power" is intended to be employed in the narrow sense which connotes the "adhesion" situation in order to render a contractual term destructible on the ground that the consumer has not been provided with the opportunity to co-determine the terms of the contract, such a concept is not sustainable.[49] As earlier pointed out,[50] various facts evince that the Directive is inclined to hold as such in its inclusion of the "strength of bargaining positions" as a criterion for the assessment of "good faith". This fallacy calls for an amendment.

1.2 Inducement to Agree to the Term

Apparently, this factor concerns procedural impropriety. As with what we have commented on the appearance of this factor in UCTA,[51] if this criterion is inserted in the Directive to encompass situations other than that involving the common law misrepresentation, it could perhaps embrace the situation where a seller or supplier takes advantage of the circumstances of weakness of the consumer. On this point, this thesis holds that it is more wise to leave such a situation to be treated under the operation of the equitable doctrine (and that the equitable doctrine should be developed *under a different general rule* to be applicable to a wide range of circumstances of weaknesses) in order to prevent an increase in the level of abstraction in judicial reasoning which is likely to result from conglomerating factors relating to the advantage-taking and factors not involving the advantage-taking.

1.3 Sale or Supply to the Special Order

Under the Directive, particular regard, when making an assessment of "good faith", shall also be had to whether the goods or services were sold or supplied to the special order of the consumer. In UCTA, this criterion[52] is apparently of peculiar

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[49] See Chapter 3, p. 21, Chapter 4, p. 26.

[50] See p. 261, *supra.*

[51] See Chapter 3, p. 176.

[52] The wording in Schedule 2 to UCTA is as follows: " whether the goods were manufactured, processed or adapted to the special order of the customer": see Chapter 3, *supra.*

application to disclaimers of statutorily implied undertakings as regards the quality, fitness for purpose, or correspondence with description. The significance of this criterion in this very context is thus self-explanatory: where the departure of the goods or services from a satisfactory quality, fitness for a particularly specified purpose or from description is due to any special order of the buyer or the receiver of the services, such party is not justified in contending that the seller or supplier is in breach of those mandatory undertakings; and by the same token, the seller or supplier should be allowed to disclaim liability in this situation. As the Directive applies to general contractual terms including exclusion clauses, the identical criterion applies in the same fashion.[53]

1.4 Fair and Equitable Dealing

The Directive specifies that the requirement of "good faith" may be satisfied where the seller or supplier deals fairly and equitably with the consumer, taking into account the consumer's legitimate interests. This criterion appears to be a catch-all device and its implications remain unclear. Arguably, it embraces the use of small, hidden or inconspicuous print which is prevalent in standard-form contracts. In addition, monopolistic power might also be regarded as "unfair and inequitable" dealing. At its most extreme, improprieties under the traditional common law may also be caught by its long-armed net.

It is noted that the Directive does not include the "state of knowledge" of the parties as a separate criterion for the assessment of procedural unfairness (under the "good faith" mechanism). It should be recalled, for the sake of comparison, that this criterion has been expressly stated as an individual guideline for the determination of "unreasonableness" under UCTA. It is submitted that the situation where a consumer has accepted an unfair term as a result of the lack of knowledge of the existence or implications of the term is intended to fall within the ambit of this "fair and equitable"

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[53] It should be noted that under UCTA these disclaimers are subjected to judicial scrutiny as to reasonableness only when they are contained in business contracts; the Act, by its sections 6 and 7, absolutely prohibits their insertion in a contract with a person dealing as consumer. Thus, in this instance, the conceptual framework employed in the Directive is more plausible. Such disclaimers are not void *ab initio* against a consumer.

heading as well.[54] Indeed, the particular attention on the part of Directive framers to consumers' inability to understand contract terms is visualised from the Commission's Explanatory Memorandum to its proposal of the draft directive to the Council. In this Memorandum, the justification for putting forward this directive was expressed to rest upon the following fact: "It cannot be assumed that consumers who cross frontiers to buy goods and services, or to invest or acquire property in other Member States, have understood and agreed the terms of a contracts they have made".[55] It should also be recalled that this thesis has suggested that insofar as incomprehensibility is concerned the law should allow the ignorant party to plead ignorance about the meaning of a contract term only when the unintelligibility in question is of the level which prevents *people in general* from comprehension. On this point, the Directive is prone to produce the same result as long as it is more likely to be discerned that the use of such terms as most people are capable of understanding is fair and equitable dealing.

One critical observation can, however, be made in this connection. While the use of small or hidden print can, without difficulty, be conceived of as an incident of the deviation from "good faith" in the contractual negotiations, the use of complex legalistic terms by sellers or suppliers is hardly discernible as an embarkation on "bad faith". This point has particularly been advanced in Chapter 1. For this reason, this

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[54] In drafting the Regulations implementing the Directive, the Department of Trade and Industry took this view when it decided not to include a reference to conspicuousness and lack of understanding in Schedule 2 (which sets out factors to be taken into account in assessing "good faith"): see DTI's consultative paper entitled "*Implementation of the EC Directive on Unfair Terms in Consumer Contracts (93/13/EEC): A Further Consultation Document*", cited in Brownsword *et al*, *op. cit.*, (footnote 32, *supra*), at 254 (at note 30). It should be noted that the fact that the problem of the lack of knowledge of the existence of contract terms caused by an absence of practical opportunity to ascertain the terms (transaction haste) was not mentioned in this document indicates that the DTI still overlooked this problem. This issue even eludes Brownsword *et al*'s discussion in the article above. For discussion on this point, see p. 268, *infra*.

[55] See the Sixth Report, *op. cit.*, (footnote 17, *supra*), p. 36. [(COM (90) 322]

In "The New Impetus", the Commission appeared to be also concerned with the situation where consumers are unable to understand a foreign language used in contracts. It was said: "Consumers going from one Member State to another...have to deal with standard form contracts, often in a foreign language. This requires protection against unfair contract terms": see *op. cit.*, (footnote 17, *supra*), cl. 30. This seemed to be a largely implausible argument. A consumer who decides to enter into a contract in another country is expected to be familiar with the language of that country. To allows litigation on this ground will endanger industry's incentives. Moreover, the situation where the lack of conversance of the contract language is *individually* apparent before the firm or its agent is the instance of advantage-taking of special disability, in respect of which remedy should be available under a different rule—equitable doctrine.

thesis contends that the decision of the Directive's framers to conglomerate factors descriptive of procedural unfairness under the umbrella of "good faith" is largely unsound. Proponents of this long-armed "good faith" might argue that in the case involving the complexity of contractual terms "unfair and inequitable dealing" and the resultant breach of "good faith" lies in the fact that sellers or suppliers have failed to disclose their implications to consumers. Nonetheless, as already advocated in Chapter 1, this argument is hardly sustainable when such disclosure has become impractical in modern market conditions.

A fortiori, whether the Directive provides redress in the situation where an unfair term (though possibly conspicuous and comprehensible) has not been known to the consumer as a result of transaction haste is problematic. Obviously, such a situation has nothing to do with "bad faith" or "fair and equitable dealing". It has been pointed out in Chapter 1 that transaction haste is an impulsive outgrowth of modern trade. It is not clear cut whether the framers have deliberately excluded this scenario from the protection under the Directive. Nevertheless, even if the framers did not so intend, the exclusion of this situation is an inevitable consequence of the application of the "good faith" expression, with the result that the shortcomings of the rules announced in the ticket cases as well as *L'Estrange* v. *Graucob Ltd.*[56] remain unresolved in the context beyond exclusion clauses.[57] Thus, the Directive is critically insufficient in this regard and deserves an amendment. It is, therefore, suggested that the Directive should clearly state that the lack of knowledge of the existence or implications of a contract term, whether it is caused by inconspicuousness, transaction haste (absence of opportunity to ascertain contract terms), or incomprehensibility, is procedural deficiency which gives rise to judicial scrutiny of fairness in the substance of the term concerned. One may note that as the Directive gives member states the option to afford consumers a higher level of protection through more stringent domestic provisions,[58] the Regulations

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[56] [1934] 2 K.B. 394.

[57] In the exclusion clause context, UCTA is of assistance as long as the state of knowledge of the parties is required to be taken into account without its being linked to "good faith": see Chapter 3, *supra*.

[58] Article 8 and recital 12 of the preamble of the Directive. It is noted that beyond the issue now under consideration, those who support the notion of protecting businessmen may rely on this Article in arguing that UCTA's applicability to business contracts is the more stringent measure.

draftsmen should do so in relation to the "state of knowledge" of consumers as explained above.

As earlier mentioned, the catch-all feature of the "fair and equitable dealing" heading is capable of sweeping monopoly under its ambit although the use of a monopolistic power may also be embraced by the "strength of bargaining positions" criterion above. Based on the arguments previously addressed in Chapter 1, it is unnecessary for the Directive to allow a contract term to be destructible as unfair on the ground of monopoly.

2. Substantive Unfairness

2.1 General Criteria for Assessing the Unfair Character of Contract Terms

The procedure-substance dichotomy is more appropriately pursued in the Directive than in UCTA. While the said Act, as demonstrated in Chapter 2, mostly states factors descriptive of procedural unfairness in the manner which looks like indicators of substantive unfairness, the Directive makes a clear and distinct substance of each echelon of unfairness. As Article 3 indicates, the substantive unfairness of a contract term lies in the "*significant imbalance in the parties' rights and obligations arising under the contract to the detriment of the consumer*". This serves as a general criterion for assessing the unfair character of a contract term.

2.1.1 Detriment to the Consumer

At first sight, the statement "to the detriment of the consumer" might appear superfluous, in the sense that a "significance imbalance" (in the contractual rights and obligations) will necessarily result in the detriment to the consumer without any need of its individual proclamation. On reflection, however, this qualification proves praiseworthy in two senses. First, as noted by Howells,[59] it will prevent a claim of "unfairness" in respect of contract terms which may have been *potentially* unfair to the consumer but may not *actually* have been detrimental to him as events unfolded. This occurs in the circumstance in which the initially unfair result of the term in question has

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[59] *Op. cit.*, (footnote 29, *supra*), p. 40.

subsequently been desired by the consumer, as epitomised in the case where the term allows a seller to terminate the contract even upon an extremely minor default on the part of the buyer but it has turned out that the buyer himself regrets the purchase and is indeed desirous to have the contract terminated. In this situation, unless the contract contains other unfair clauses such as the clause authorising the seller to retain the total price already paid by the buyer, that termination clause should not give rise to an otherwise vexatious action. This contention, however, is not problem-free. It may run counter to the requirement laid down in Article 4(1) that unfairness of a contractual term shall be assessed *as at the time of the conclusion of the contract* and by referring to all circumstances attending the conclusion of the contract.[60] This inconsistency seems to elude Howells's notice. A possible solution to this conflict would appear to lie in treating the "detriment" element as a qualification attached to the general principle that the determination of unfairness is to be made as at the time of the conclusion of the contract. Nonetheless, this problem does not arise in practice since it is very unlikely that a consumer in such a scenario will litigate a term which has caused him no hardship.

The other possibility where the "detriment" requirement can be meaningful is the scenario in which although the particular term used by the seller or supplier may be discerned as unfair the hardship which occurs to the buyer does not stem from the unfair character of such term itself but from other circumstances. Again, this scenario seems to be overlooked by Howells. Unlike the scenario explained in the preceding paragraph, the practical likelihood of litigation by the buyer in this case is not unimaginable. As long as the existence in England of a case of this scenario is not to this thesis's knowledge, an American case can afford a striking illustration. In *Campbell Soup Co.* v. *Wentz*,[61] a claim was made, in response to an action for specific performance, by carrot growers in Pennsylvania (who had agreed to sell to a soup company Chanteney red cored carrots, recognised as unique carrots due to their shape, colour and texture, to be grown on fifteen acres of their farm) that the contract was unenforceable since it contained a provision that the company could reject carrots in

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[60] Regulation 4(2).

[61] (1948) 172 F.2d 80.

excess of twelve tons to the acre but the seller-farmer could not in any event sell carrots (including those rejected by the company) to anyone else unless the company agreed. Although the sum total of its provision, as the United States Court of Appeals (Third Circuit) addressed, "drove too hard a bargain" and the clause above "carried a good joke too far", the hardship on the farmer in this case did not emanate from the unfair character of this particular clause but from the fact that the carrot market price subsequently rose up to three times the contract price. The fact that the Court held the contract unfair and refused specific performance on this ground gives rise to criticism. In contrast, the Directive, arguably, gives no relief to a party in this case.

2.1.2 "Significant Imbalance"

This terminology may not be alien to the English judiciary. It should be recalled that Lord Brightman in the Privy Council case of *Hart* v. *O'Connor*[62] has once described substantive unfairness under the expression "contractual imbalance".[63] The Directive has perhaps amplified this position by clearly stating that the imbalance is one "in the parties' rights and obligations arising under the contract". The crucial amplification is that the imbalance must be "significant" so that a minor imbalance is not regarded as unfair. This appears a wise design since it is not efficient to allow a very small contractual disadvantage to reach the courts at the expense of otherwise more wasteful public funds.

Of course, what constitutes a "significant imbalance" is, by its nature, unsusceptible of any precise definition. On this point, it is clear that the Directive has introduced the "overall assessment" approach. First, it is addressed so in recital 16 of the preamble: "the assessment ... of the unfair nature of terms...must be supplemented by means of making an overall evaluation of the different interests involved". Further, and more centrally, Article 4(1)[64] requires that the consideration of unfairness of a particular term be made by taking account of all other terms of the same contract or of

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[62] [1985] A.C. 1000, at 1017.

[63] See Chapter 2, p. 150, *supra*.

[64] Regulation 4(2).

another contract on which the contract in question is dependent.[65] This is unquestionably plausible, given that an individual term may appear unfair (in the sense of causing a significance imbalance) when taken in isolation but will not be so when considered in association with other terms. For instance, a contract term, placed under the heading "The Supplier's Rights" may allow the supplier to terminate the contract unilaterally without notice but it appears that another term which is placed under a separate heading provides that the option to terminate the contract must be exercised upon grave default by the other party, or that the corresponding right is also given to that other party. An illustration furnished by Lawson is also worth a mention. It is, at first blush, unfair of a term in a maintenance agreement to specify very restricted call-out times but, at perusal, this unfair restriction is removed by a term in the sale contract, to which the maintenance agreement relates, which in fact provides for replacement equipment to be available on a 24-hour basis.[66] Finally, the overall-balancing approach is given more force when this Article further requires that reference be made, in assessing unfairness, to "all the circumstances attending the conclusion of the contract".

2.2 Non-Exhaustive List of Unfair Terms

The Directive provides, in the Annex to Article 3(3),[67] a list of the terms which may be regarded as unfair. This is another laudable characteristic, for the "uncertainty" which arises from the determination of "unfairness" can be alleviated to some extent when appropriate criteria for assessing the unfair substance of contract terms are spelled out as guidance to sellers or suppliers in order that they can foresee which terms may be contested as unfair and decide whether to avoid the inclusion of such terms in their contacts with consumers in the first place or proceed with those terms

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[65] In this respect, Meryll Dean, in "*Unfair Contract Terms: The European Approach*" (1993) 56 M.L.R. 581 at 583, asserts that the Directive differs from UCTA in that the latter merely concerns itself with terms in isolation while the former requires the consideration of the particular term's interaction with other terms. Although the truth can be found in this assertion, it should not be overstated. It must not be forgotten, that is, that the requirement under section 11 of UCTA that regard be had to "(all) circumstances" makes it possible for the courts to determine "reasonableness" of exclusion clauses by reference to other terms as well.

[66] *Op. cit.*, (footnote 18, *supra*), p. 165.

[67] Schedule 3 to Regulation 4(4).

and take the risk of their nullification by the courts. This point will be fully examined in the next chapter.

As it has once occurred in England in the Law Commission in relation to UCTA, the notion of providing a list indicative of unfair terms might be felt to be inapposite, in that the omission from the list of a term which may well be unfair in a particular case may create a false implication that it should be treated as fair and, by the same token, the inclusion of particular terms in the list may incorrectly attract more importance than they merit. We have argued in Chapter 3 that this argument seems to be weakened by the fact that the problem can be solved by the inclusion of a clear statement that the guidance provided by the list does not preclude the conclusion that other terms not included in the list are unfair and *vice versa*. Indeed, such solution is found in the Directive when Article 3(3) makes clear that the list is "an *indicative* and *non-exhaustive*" list.[68] Recital 17 of the preamble also states that the list "can be of indicative value only". In addition, the requirement, as explained above, that *all circumstances attending the conclusion of the contract* be taken into account can be a support of this "grey-list" attribute. Before further discussion, this list, with its break-down into 17 subparagraphs, deserves full quotation:[69]

(a) excluding or limiting the legal liability of a seller or supplier in the event of the death of a consumer or personal injury to the latter resulting from an act or omission of that seller or supplier;

(b) inappropriately excluding or limiting the legal rights of the consumer *vis-à-vis* the seller or supplier or another party in the event of total or partial non-performance or inadequate performance by the seller or supplier of any of the contractual obligations, including the option of offsetting a debt owed to the seller or supplier against any claim which the consumer may have against him;

(c) making an agreement binding on the consumer whereas provision of services by the seller or supplier is subject to a condition whose realization depends on his own will alone;

(d) permitting the seller or supplier to retain sums paid by the consumer where the latter decides not to conclude or perform the contract, without providing for the consumer to receive compensation of an equivalent amount from the seller or supplier where the latter is the party cancelling the contract;

(e) requiring any consumer who fails to fulfil his obligation to pay a disproportionately high sum in compensation;

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[68] Regulation 4(4).

[69] The *ipsissima verba* of the list contained in Schedule 3 to the Regulations are *verbatim* identical to that of the Directive's list.

(f) authorizing the seller or supplier to dissolve the contract on a discretionary basis where the same facility is not granted to the consumer, or permitting the seller or supplier to retain the sums paid for services not yet supplied by him where it is the seller or supplier himself who dissolves the contract;

(g) enabling the seller or supplier to terminate a contract of indeterminate duration without reasonable notice except where there are serious ground for doing so;

(h) automatically extending a contract of fixed duration where the consumer does not indicate otherwise, when the deadline fixed for the consumer to express this desire not to extend the contract is unreasonably early;

(i) irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract;

(j) enabling the seller or supplier to alter the terms of the contract unilaterally without a valid reason which is specified in the contract;

(k) enabling the seller or supplier to alter unilaterally without a valid reason any characteristics of the product or service to be provided;

(l) providing for the price of goods to be determined at the time of delivery or allowing a seller of goods or supplier of services to increase their price without in both cases giving the consumer the corresponding right to cancel the contract if the final price is too high in relation to the price agreed when the contract was concluded;

(m) giving the seller or supplier the right to determine whether the goods or services supplied are in conformity with the contract, or giving him the exclusive right to interpret any term of the contract;[70]

(n) limiting the seller's or supplier's obligation to respect commitments undertaken by his agents or making his commitments subject to compliance with a particular formality;

(o) obliging the consumer to fulfil all his obligations where the seller or supplier does not perform his;

(p) giving the seller or supplier the possibility of transferring his rights and obligations under the contract, where this may serve to reduce the guarantees for the consumer, without the latter's agreement;

(q) excluding or hindering the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal provisions, unduly restricting the evidence available to him or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract.

Subparagraphs (a) and (b) are reminiscent of UCTA.[71] Part of subparagraph (q) captures contract terms by which the *proferens* intends to cause the other party unfair

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[70] This type of term was used in the contract in *Henningsen* v. *Bloomfield Motors Inc.* (1960) 161 A.2d. 69, already discussed in Chapter 4, *supra*.

[71] S. 2(1) and s. 3 respectively. With regard to a disclaimer of liability for death or personal injury, it should be recalled that UCTA imposes an absolute ban on its use. As we have earlier addressed, the Directive is based on the procedural-substantive framework. In a strict sense, an exclusion of liability for death or personal injury will be upheld under the Directive scheme if the consumer has not misunderstood its implication. However, it remains unclear whether the framers of the Directive intended to treat this term as *exceptionally* destructible on a purely substantive ground. As for the

difficulty in enforcing his rights against the *proferens* rather than directly exclude such rights or create an unfair imbalance in the rights to the detriment of the other party. As we have seen, this captive device is also found in section 13 of UCTA.[72] In addition, subparagraph (e) is apparently directed at penalty clauses which indeed fall under the long-established supervisory jurisdiction of the English common law. Notwithstanding all this, the list seems to be useful on the whole. Some subparagraphs describe terms the unfair substance of which is self-evident or self-explanatory. This is true of the subparagraphs (b), (c), (f),[73] (m), (o) and (q). In addition, although a number of contract terms are described under various items—items (a)-(q)—of the list, many of those terms can be induced into a generally useful criterion. Fuller discussion on this issue is deferred to Chapter 6. Suffice it to give the following examples here. The grouping of items (c), (d), (f) and (o) together leads to a criterion that a contract term will be unfair when it "gives one party a right without giving the corresponding right to the other where such corresponding right is necessary in the circumstance".[74] Similarly, the "necessity for the protection of legitimate interests" is the criterion derived from items (g),(h), (j), (k), (l) and (p).[75]

2.3 Qualification as to "Price" Terms

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exclusion of liability for non-performance, it might be argued that in this very context the draftsmanship in UCTA appears more astute than that in the Directive since UCTA covers terms which allow a substantially different performance from reasonable expectation. However, as explained in Chapter 3, this UCTA provision is intended to forestall attempts to evade the operation of the Act by recasting a term to have a false appearance of non-exclusion clause. This instance is undoubtedly covered by the Directive, given that the application of the Directive is, after all, not restricted to exclusion clauses.

[72] However, the captive instrument reified in subparagraph (q) of the Directive's list appears wider than that embodied in section 13 of UCTA, in that the latter only relates to terms which exclude or restrict liability. It is submitted that subparagraph (m) can be viewed as a captive device as well.

[73] In relation to subparagraph (f), it is only the second part of it—"permitting the seller or supplier to retain the sums paid for services not yet supplied by him where it is the seller or supplier himself who dissolves the contract"—that exhibits the self-evident unfairness. The first part—"authorizing the seller or supplier to dissolve the contract on a discretionary basis where the same facility is not granted to the consumer"—describes the "mirror image", another criterion for ascertaining an unfair character of unfairness: see below.

[74] This is what Hondius terms the "mirror-image rule": see *op. cit.*, (footnote 29, *supra*), p. 41. But in relation to the subparagraph (f), only the first part of it represents the mirror image.

[75] Only the item (i)—the term which has the effect of irrevocably binding the consumer to terms with which he had no real opportunity of becoming acquainted before the conclusion of the contract—appears more relevant to procedural unfairness: the state of knowledge of the parties.

A meritorious qualification attached to the assessment of an unfair character of a contract term under the Directive is the prevention of a "price term" from being contested as unfair. It should be recalled that this thesis has advocated in Chapter 1 the reasons for not applying a general rule for the control of unfairness in contracts to this type of term. It is, therefore, fortunate that the arguments addressed there have now found an empirical recognition in Article 4(2) of the Directive which provides, *inter alia*, that the assessment of the unfair nature of the terms shall not relate to the adequacy of the price and remuneration in so far as these terms are in plain and intelligible language.[76] The restriction of this caveat to the case where such terms are in plain and intelligible language is also cerebrally meaningful. It will not exclude from the operation of the Directive the situation where the consumer does not understand the contract price due to, for example, the complexity in the total-charge calculation method set forth by the contract, such a situation as is illustrated in the American case of *American Home Improvement, Inc.* v. *MacIver*[77] which has been discussed in Chapter 4. Nonetheless, this "in so far as these terms are in plain and intelligible language" proviso can be criticised as incomplete. As we have seen, it is not only the unintelligibility that can prompt ignorance of price terms. Consumers may also be unaware of the total price because the term which specifies the calculation of price is, although already expressed in plain and intelligible language, put in small print (or

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[76] Regulation 3(2)(b). It should be also noted that, as far as prices of goods and services are concerned, the Community Programmes for the Consumer Protection and Information Policy merely strived to provide consumers with sufficient information to enable them to make a rational choice between competing products and services. To this end, the said Programmes sought to lay down common principles and rules for the following: the labelling of products; the clear statement of particulars of foodstuffs; the statement of prices per unit of weight or volume: see the Preliminary Programme cls 34, 35. In addition, the Commission was required to conduct surveys of retail prices in an endeavour to inform the public of price differences within the Community: see cl. 41. The attention on the "price transparency" rather than "price control" was more apparent in the Second Programme. It was summed up in clause 41: "To this end the Commission will take supplementary measures which must in no case be price control or price-fixing measures but must supply appropriate information to several different sections of the public...." The position remained the same in The New Impetus: see *op. cit.*, (footnote 17, *supra*), cls 32, 33, 35 and 36.

Cf. the German Standard Contract Terms Act of 1976. The Act does not introduce any kind of price control: see Otto Sandrock, "*The Standard Terms Act 1976 of West Germany*", (1978) 26 Am. J. Com. L. 551, at 562. For an excellent study of the judicial response to the problem of standard contracts as well as coercive contracts under the general provisions of the German Civil Code relating to "good morals" and "good faith" (Articles 138 and 142), see John P. Dawson, "*Unconscionable Coercion: The German Version*", (1976) 89 Harv. L.R. 1041.

[77] (1964) 201 A.2d. 886, previously discussed in Chapter 4, *supra*; see also Chapter 1, p. 40.

otherwise made inconspicuous) or is incapable of ascertainment in a normally hasty transaction. All these types of ignorance should be embraced by the caveat above. It is a puzzle when this issue has not been raised by academics.

2.4 The "Main Subject-Matter" of the Contract

Another qualification attached to the concept of "unfairness" is one relating to the "main subject-matter of the contract". Under Article 4(2), the assessment of the unfair nature of a contract term shall not relate to the definition of the main subject-matter of the contract in question.[78] In a contract under which goods or services are to be parted with or provided, those goods or services are certainly the subject-matter of the contract. It does not mean, however, that only the goods or services can constitute the subject-matter of a contract. Some contractual terms which set out rights and obligations can well be perceived of as forming the subject-matter of the contract. A subject-matter term is different from general terms of a contract in that it is the "core" or "essence" of the contract and, importantly, it is intimately connected with the *particular* intention of the parties. When a contract is *specifically* made for the performance of a *particular* thing, the term which defines or describes *that thing* and *that particular performance* represents the subject-matter of the contract.

The qualification that a term which is descriptive or representative of the subject-matter of a contract is to be insulated from judicial review of unfairness is understandable. Such a term emanates from the particular intention of the parties—when one thing is specially intended, that very thing cannot be regarded as unfair. Indeed, as with the case of "price" terms above, the requirement that "subject-matter" terms be insulated from judicial review only in so far as they are in plain and intelligible language is prescribed in order to ensure that they have emanated from the full understanding and real intention of both parties.

In effect, recital 19 of the preamble provides an illustration by referring to insurance contracts: "the terms which clearly define or circumscribe the insured risk and the insurer's liability shall not be subject to such assessment [of unfair character]

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[78] Regulation 3(2)(a).

since these restrictions are taken into account in calculating the premium paid by the consumer". A few words perhaps need to be said to clarify this position. If a contract between the parties is, for example, intended to be one of insurance of the premises against the risk of fire *only*, such is the main subject-matter of this contract. The insured cannot contend that the term which describes that the insurer's liability does not cover flood or vandalism is unfair although any of other terms which have the effect of excluding or limiting the insurer's liability for *fire* might be destructible as unfair—the former is descriptive of the subject-matter of the contract whereas the latter is an ordinary term.

In reality, doubt may be cast as to whether the qualification about the term which defines or describes the main subject-matter of the contract is necessary. Given that such a term is *particularly* intended by the parties to the contract, its substantive result is without any procedural unfairness. Thus, if that result appears harsh, it is merely, to employ the terminology adumbrated in Chapter 1 of this thesis, substantive unfairness *per se*. The dual framework of the Directive already holds that no contract term can be destructible as unfair in the absence of procedural flaws (which are framed under the "good faith" maxim above). In this sense, the qualification as to the "main subject-matter" appears no more than superfluous.

Indeed, its inclusion may probably do more harm than good. It will attract a plea by the seller or supplier that the term litigated by the consumer is one which defines or describes the subject-matter of the contract rather than an ordinary term. This "subject-matter" plea will trigger an uneasy burden on the part of the courts to determine whether the term in question represents the subject-matter. Admittedly, in many cases a fine distinction between a term which describes or defines the subject-matter of the contract and other terms is not a fine one. A court is in no better position than the parties to the contract to ascertain their real intention at the time of the contract. For instance, in a contract of "fire" insurance for a house which contains the term that the insured will be indemnified for loss only when no gas-operated appliance is used in the home, the court will be faced with difficulty in identifying whether the contract in question was specially negotiated and designed to insure a house which has no gas-operated appliance against fire or whether it was merely intended to be an

ordinary contract of fire insurance. If it is the former, the term in question is the subject-matter term; in contrast, if the latter was intended, the term is an ancillary term—in this case, an exclusion clause.[79] However, the problem is less acute in the context of English law of contract, for the "objective theory" will compel the conclusion that the term in the example above is an exclusion clause rather than a "subject-matter" clause.[80] Unless the contract concerned states the clear intention of parties, the seller's or supplier's "subject-matter" plea can hardly be successful. Some have argued that a court should confine the "main subject-matter" within the narrowest of bounds.[81] However, it is submitted that the problem can be best resolved by eviscerating this "subject-matter" qualification itself from the provisions of the Directive. All "subject-matter" terms, which represent the intention of the parties, will be *ab ovo* excluded from judicial review (without the courts having to make a distinction between definitional terms and other terms) as long as the Directive requires the lack of knowledge of the implications of the contract terms as the pre-condition for the examination of their substance. This truism seems to have been unnoticed in legal writings.

2.5 The Nature of the Goods or Services

Finally, the Directive directs that the nature of the goods or services under the contract must also be taken into account when unfairness of a contract term is

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[79] An example given by Howells, in *op. cit.* (footnote 34, *supra*), p. 39, seems useful. Howells points out that it is difficult to ascertain whether the clause in an insurance contract for a bicycle which only covers theft when a bicycle is in a garage is the clause which defines the obligation as "insuring the bicycle when in the garage" or is a term restricting the obligation of "insuring the bicycle" by excluding liability where it is not in the garage.

[80] Considered in this light, the contention by Collins, in *op. cit.* (footnote 43, *supra*) at 243, that the Directive's "subject-matter" provision coupled with recital 19 of its preamble "threatens to exempt insurance contracts from control by the back door" seems to be overstated.

[81] See, for example, Brownsword *et al*, *op. cit.*, (footnote 32, *supra*), at 251. *Cf.* Elizabeth Macdonald, "*Mapping The Unfair Contract Terms Act 1977 and The Directive on Unfair Terms in Consumer Contracts*", [1994] J.B.L. 441 at 461 where it is contended that the fact that almost all contractual terms are *definitional* terms would make most contract terms excluded, by Article 4(2) of the Directive, from its fairness test, thereby rendering the Directive "largely ineffective". This contention may be overstated. It is true that contract terms which set out rights and liability are, at the level of form, *defining* the obligations. However, Article 4(2) excludes the fairness test from applying merely to such terms as defining the "subject-matter"—the "core" obligations—of the contract concerned, with the consequence that other definitional terms are still subject to the fairness test.

assessed.[82] The significance of this requirement is conceivable. Certainly, the Directive does not intend the nature of the goods or services to be a basis for the claim that the quality of the goods or services is not commensurate with the price paid, for the adequacy of the price or remuneration is excluded from the assessment of unfairness, as previously explained. Rather, the nature of the goods or services will cast light on the determination of an unfair character of a contract term in the sense that the production of some goods or the performance of some services may confront such a high degree of complexity and difficulty that sellers or suppliers are justified in, for example, excluding liability for some losses sustained by consumers or in altering some characteristics of the products or services.[83] Admittedly, such complexity may be more likely to occur in the case in which goods or services are sold or supplied to the special order of the consumer.[84]

V. ADDITIONAL REQUIREMENT: PLAIN AND INTELLIGIBLE LANGUAGE

Apart from subjecting contractual terms to judicial surveillance *vis-à-vis* fairness, the Directive requires sellers or suppliers to couch their terms, where the contract with the consumer is in writing, in plain and intelligible language.[85] Obviously, this requirement is intended to alleviate the problem of consumers' inability to understand implications of complex terms used by traders. It should be noted, however, that the "plain and intelligible language" requirement is introduced merely as an auxiliary to, not in any way as the preclusion of, the empowering of the courts to nullify unfair terms. This is a correct account and is in line with the proposal made in this thesis.[86]

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[82] Article 4(1) and recital 18 of the preamble, Regulation 4(2).

[83] The consideration of the nature of the goods or services therefore bears particular relevance to fairness of the contract term described under item (k) of the list.

[84] Hence, there exits an apparent connection, though unknown whether it is intentional or coincidental, between the consideration of "the nature of the goods or services" now being discussed and one criterion of "good faith": "whether the goods or services were sold or supplied to the special order of the consumer" which has been discussed previously.

[85] Article 5, Regulation 6.

[86] See Chapter 1, p. 101, *supra*.

Coupled with this requirement above is the mandate that if there is any doubt as to the meaning of a term the interpretation most favourable to the consumer shall prevail. This is not in any way new to English law, for it is merely the "*contra-proferentem*" rule of interpretation at common law.

VI. ADMINISTRATIVE ACTIONS FOR THE CONTROL OF UNFAIR TERMS

The Directive also provides for administrative actions for the control of unfair contract terms made with consumers. This is embodied in Article 7. Before these substantive provisions are considered, it seems useful to address in this section some necessary discussion on the role of administrative actions in regard to the policing of unfairness in the terms of individual contracts. However, as the main concern of this thesis is with the control in the form of entrusting the courts with the scrutiny of contract terms when an individual party initiates litigation, this section is not a place for a full exploration on the issue as to how best to activate such administrative pattern of control. It is here merely intended to point out that the introduction of this form of control should not, as with the "plain and intelligible language" requirement above, be adopted to the preclusion of the courts' exercise of this power in an *individual action* brought by the aggrieved party. Rather, the administrative control should be supplementary to such judicial supervisory jurisdiction.

1. Forms of Administrative Control

Various forms of administrative control of unfair terms in contracts are found to have been employed by legislatures in England and elsewhere. The common method is what is often called the "*preventive action*" which signifies the prevention of the use by firms of contracts terms conceived of as unfair to consumers. The philosophy underlying this form of action is that the problem of unfairness arises not only when an

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In its considering the draft directive, the House of Lords Select Committee on the European Communities suggested that the Directive state that it applies to "terms which are unreadable or likely to be misunderstood by consumers because they are not in plain language": see Sixth Report, *op., cit.*, (footnote 17, *supra*), paras 74, 91. Although this view may, at first sight, seem commendable in that it precisely holds ignorance about the implications of contract terms as procedural unfairness which will give rise to judicial surveillance over the substance of the terms concerned, it can be criticised as inadequate by reason that it has failed to embrace the other two types of ignorance: ignorance of inconspicuous (though expressed in well plain and readable language) terms and ignorance caused by an absence of opportunity to ascertain the terms.

individual party initiates litigation in a court of law but it comes forth as early as the terms are put into use by firms. More precisely, the circulation in the market of standard forms incorporating unfair terms immediately presents unfairness to consumers. Based on this premise, there is no reason for the rectification of those terms to await an initiation of a lawsuit by the aggrieved party. Consumers should be protected in the first place through the mechanism by which those circulated unfair terms are prevented from their use. Notably, this method of control can also be regarded as the "representative action", in the sense that consumers are generally represented and their interests are consequently looked after even in an early stage without their having to litigate on an individual basis.[87] Admittedly, this action serves as an appropriate solution to the problem posited by financial constraints which prevent an individual consumer from having access to the courts for the direct rectification of contract terms suffered by him.

The substance given to the preventive action differs from one country to another. Some European countries have employed the two-tier system whereby public officials[88] or private consumer organisations[89] are empowered to conduct a preliminary investigation of contracts terms used in the markets and refer such terms as considered unfair to consumers to another adjudicatory institution[90] for determining as to their unfairness and then restraining firms from their further use if those terms are indeed ruled unfair. The two-tier system is also found in England. The English legislature, by the Fair Trading Act 1973, chose to entrust the Director-General of Fair Trading, the office established thereunder, with the duty of keeping under review commercial

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[87] However, some seem to restrict the "representative action" terminology to the scheme under which private consumer organisations are permitted to initiate these preventive proceedings. It is in this sense that it has been said that the United Kingdom law knew of no representative action although in reality the Director-General of Fair Trading is empowered by the Fair Trading Act 1973 to prevent the use by firms of terms which adversely affect the economic interests of consumers; as to which, see below.

[88] For example, ombudsmen in Sweden.

[89] For example, certain consumers' associations under § 13 of the Standard Contract Terms Act 1976 of Germany: see von Marschall, *op. cit.*, (footnote 29, *supra*), at 286; Sandrock, *op. cit*, (footnote 76, *supra*), at 567.

[90] This may be a special tribunal or board (as in Israel: see footnote 96, *infra*), a specific court or a special panel of an ordinary court (as in The Netherlands), or even an ordinary court (as in Germany).

activities relating to goods or services to consumers[91] and empower the holder of this office to refer to the Consumer Protection Advisory Committee, a body specially set up by the Act as well,[92] a particular *consumer trade practice which may affect adversely consumer interests* for determining whether it does in fact adversely affect the economic interests of consumers in the United Kingdom[93] and, if the Committee reaches an affirmative opinion, making a Report to the Secretary of State in order that an appropriate Order is made. Such a reference may be accompanied by remedial proposals to which the Order may give effect subject to any modification proposed in the Committee's Report.[94] The practices susceptible of reference include not only those which have, or likely to have, the effect of misleading consumers or subjecting them to undue pressure. But the Act also encompasses the practice of using unfair terms in contracts offered to consumers, as is reflected in the wording of section 17(2)(d): "[consumer trade practice] of causing the terms or conditions, on or subject to which consumers enter into relevant consumer transactions, to be so adverse to them as to be inequitable". Orders made by the Secretary of State impose criminal sanctions on the use of such terms.[95]

Of note is that the "preventive action" does not preclude the determination of unfairness in the terms of the contract as long as the substance of the terms in question must be first determined whether they are unfair before they can be prohibited from further circulation in the market. It should be further noted, however, that since it is

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[91] S. 2.

[92] S. 3.

[93] S. 13.

[94] S. 22.

[95] In addition to these proceedings, the Act also confers upon the Director-General the power concerning the restraint of "persistent detrimental and unfair conduct". For this purpose, the Director-General may seek a written assurance from a person who has persisted in a course of conduct which is detrimental to the interests of consumers and unfair to them that he will refrain from it; and, if such an assurance is not given or not subsequently observed, the Director-General may take proceedings against the person in the Restrictive Practice Court which can make orders, *inter alia*, restraining him from such conduct. However, unfair conduct contemplated by the Act is restricted to breaches of the criminal law or failure to observe duties arising under the civil law rather than extended to the use of unfair terms: see s. 34(2) and (3). The only possibility that the use of unfair terms as such can be covered by this additional power is when the Secretary of State has made an Order prohibiting it, given that the contravention of an Order is a criminal offence.

not the case of determining unfairness in private litigation instituted by a consumer after a particular contract has actually been made, procedural unfairness is not directly involved at this stage of judging fairness. Therefore, the assessment for the preventive purpose by an adjudicatory body of fairness of the terms concerned may carry an appearance of intervention in substantive unfairness *per se*. To avoid this undesirable effect, it is necessary that such an adjudicatory body ensure that the terms to be prevented from general circulation in the market are actually unwanted by the class of consumers intended to be protected against. In so doing, procedural unfairness is taken to have generally pre-existed.

Some countries have gone further to stipulate that if the established adjudicatory agencies determine that the contract terms referred to them are not unfair such terms will be declared valid and insulated from judicial attack as unfair in individual litigation *intra partes* in an ordinary court. This is commonly known as the "*pre-validation*" approach which was first initiated in 1964 by Israel.[96] This idea was, however, not adopted in England although it was considered by the Law Commission in relation to exclusion clauses.[97]

Another account of administrative control is by way of codes of practice. This may, however, be merely a self-regulatory and extra-legal form of control in the sense that state officials are merely entrusted to encourage, but without any authority to

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[96] This is embodied in the Standard Contracts Act 1964. Section 2 of this Act allows any person who uses a standard form to refer "restrictive terms" (set out in s. 15) contained therein to the Board of Restrictive Trade Practices for determination upon their validity. If the Board, under s. 6, determines that the term is prejudicial to the consumers or gives an unfair advantage to the supplier likely to prejudice the consumers, such term can no longer be used. But, if the contrary decision is given, sections 10 and 13 prohibit an ordinary court from declaring it null and void provided that the supplier mentions in the contract that the Board has already approved the term. Following the amendments in 1969 which, by the inserted section 2A, empower the Attorney-General to refer restrictive terms in standard contracts to the Board for determination, the legislation has included the "two-tier" system as well. For commentary on this Act, see Aubrey L. Diamond, "*The Israeli Standard Contract Law*", (1965) 14 I.C.L.Q. 1410; R. Gottschalk, "*The Israeli Law of Standard Contracts*", (1965) 81 L.Q.R. 31; Comment, "*Administrative Regulation of Adhesion Contracts in Israel*", (1966) 66 Col. L.R. 1340; Adler, "*Restrictive Covenants and the Standard Contracts Law*", (1970) 5 Israel L.R. 580; Elman, "*Restrictive Terms in a Standard Contract*", (1972) 7 Israel L.R. 433; Berg, "*The Israeli Standard Contracts Law*" 1964", (1979) 28 I.C.L.Q. 560.

[97] See Law Com. No. 69, para 290-314 (pp. 101-108). It was recommended that terms in standard form contracts be submitted to the Director-General of Fair Trading for scrutiny and be deemed as having satisfied the requirement of "reasonableness" if approved by the Director-General.

compel, trade associations to prepare codes of practice to be used by their members to promote the interests of consumers. It follows, therefore, that the sanction for non-compliance with such codes is based on the disciplinary mechanism enforced by the association concerned and does not extend to non-member traders. At the Community level, the Commission has sought measures for promoting dialogue between consumer representatives and those of economic agents with a view to encouraging voluntary code of conduct within the Community.[98] In England, the power to encourage codes of practice is conferred upon the Director-General of Fair Trading under section 124(3) of the Fair Trading Act 1973. Although trade associations are not obliged to consult or seek approval from the Office of Fair Trading or other organisations representing the interests of consumers, such consultation has become a normal practice in the preparation of relevant codes.

2. Preserved Merits of Judicial Supervision

Notwithstanding the possibility of these administrative actions, it appears more overstated than accurate to conclude that they can be adopted to the preclusion of the introduction of the judicial jurisdiction to scrutinise contract terms in individual litigation *intra partes*. Obviously, the "pre-validation" approach alone can hardly be an assurance of the rarity, if not the absolute obsoleteness, of the use of unfair terms in the industry as long as there remain a number of valid reasons by which firms are disinclined to voluntarily submit their standard terms to the established adjudicatory body for the pre-vetting. Certainly, apart from the fear of unfavourable publicity resulting from such body reaching a negative decision, firms may prefer to reap benefits from the continued use of unfavourable terms to consumers rather than take a risk of loss of these gains in the event where the official body disapproves the terms submitted for the pre-vetting.[99] Indeed, the Israeli experience itself so indicated.[100] As

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[98] This was inaugurated in the Second Programme (*op. cit.*, footnote 9, *supra*). It was particularly pursued in *The New Impetus*, *op. cit.*, (footnote 17, *supra*), cl 41.

[99] See Ewoud H. Hondius, "*Unfair Contract Terms: New Control System*", (1978) 26 Am. J. Com. L. 525, at 531.

[100] Comment, *op. cit.*, (footnote 96, *supra*), at 1347. A compulsory system by which standard contracts are required to be submitted for approval appears unwise in view of bureaucratic delays which will hamper businesses. Notably, Israel decided to introduce the administrative scheme alongside the

far as the "preventive action" is concerned, empirical evidence has never shown that a sufficient number of references, in the case of the two-tier system, have been made to the established adjudicatory agencies or that, in the one-layer system, state officials have effectively exercised their power to the extent where unfair terms are almost unfound. Such evidence has been found elsewhere. The same is true in England, for it appears that very few Orders have been made since the enactment of the Fair Trading Act.[101] Finally, with regard to codes of practice, although it is not denied that this direction may appear successful (particularly in England where more than ten codes have been in use in various industries)[102] and that each code can be appropriately designed to deal with peculiar problems presented to the particular trade, judicial supervisory jurisdiction should be preserved for two reasons. First, a code of practice does not, as earlier alluded to, apply to traders not belonging to the association concerned unless these non-member traders choose to incorporate it into their contracts with customers. Secondly, and more importantly, even if the first barrier is left aside (or is not the issue, for example, when the law compels traders in a certain branches of industry to be members of relevant associations), the courts will need to work over contract terms in individual litigation where a member of the trade association concerned deals with customers in contravention of the code. Although the organisational sanction may possibly direct the violator to conciliate the matter in the

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judicial control in *ex casu* litigation. § 14 of the Act empowers the court to declare a restrictive term void in an individual action when satisfied that it is prejudicial to the customer: *ibid.*, at 1344.

[101] These are the Mail Order Transactions (Information) Order 1976 (S.I. 1976 No. 1812) which compels all mails inviting offers from buyers and requiring payment in advance to contain the true name or registered business name and business address of the person concerned; the Consumer Transactions (Restrictions on Statements) Order 1976 (S.I. 1976 No. 1813) (as amended by the 1978 Order: S.I. 1978 No. 127 to accommodate the changes made by the Unfair Contract Terms Act 1977) which prohibits a business seller from applying in notices, advertisements or statements on or with the goods terms which are void under s. 6 of the Unfair Contract Terms Act 1977 and also from providing statements about the consumer' rights against the supplier in connection with the statutorily implied conditions as to merchantable quality, fitness for the particular purpose and correspondence with description unless those statements are accompanied by the statement that the consumer's statutory rights are not affected; and the Business Advertisements (Disclosure) Order 1977 (S.I. I977 No. 1918) which requires a sale advertisement by a business seller to indicate clearly in the advertisement that the goods are to be sold in the course of business so that buyers will not misunderstand that it is a private sale to which some statutory protective provisions are inapplicable. Of note is that most of these Orders deal with *misleading terms* rather than *unfair terms*. It should also be noted that, under the Act, a contravention of an Order merely gives rise to a criminal offence without affecting civil rights under the relative contract.

[102] Amongst them are codes of practice prepared by the following industries: motors, electrical and electronic appliances, shoes, footwear distribution, travel, laundries.

consumer's favour for the sake of trade reputation, this cannot be an absolute assurance. The necessity of judicial redress is more obvious in the case where a code of practice itself contains terms unfavourable or prejudicial to prospective consumers.[103]

To sum up, the contention that administrative control is sufficient and can be adopted to the preclusion of the courts' scrutiny[104] of contract terms is not sustainable and such judicial jurisdiction should be introduced or retained alongside the administrative avenues.

3. Administrative Actions under the EC Directive

The Directive, under Article 7(1), requires Member States to provide for "adequate and effective means" to "prevent the continued used of unfair terms in contracts concluded with consumers". Evidently, this points to the preventive action. It is explained in the following paragraph of this Article that such means shall include provisions whereby persons *or* organisations who have a legitimate interest under national law in protecting consumers may take action before the courts or before competent administrative bodies for a decision as to whether contractual terms drawn up for general use are unfair so that such adjudicatory bodies can apply appropriate and effective means to prevent the continued use of such terms.[105] Apparently, it is left

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[103] Susan E. Marsh, in "*Voluntary Codes of Practice*", (1977) 127 N.L.J. 419 gives two examples of these terms (the term contained in the Motor Industry Code which provides that the seller should not quote mileage in advertisements or any documents related to the supply of the used car and the term which requires that dealers should provide all reasonable facilities to enable prospective customers to examine the car; the latter is intended to constitute a defence that the availability of examination facilities excludes apparent defects of the car although the customer has failed to conduct the examination, which was then the valid defence under case law prior to the new section 14(2) of the new Sale of Goods Act. For instructive literature on codes of practice, see also Miller, *Product Liability and Safety Encyclopaedia* (1979-1992); Page, "*Self-Regulation and Codes of Practice*", [1980] J.B.L 24; Gordon Borrie, "*Legislative and Administrative Controls over Standard Forms of Contract in England*", [1978] J.B.L. 317 at 323 and another article "*Laws and Code for Consumers*" in [1980] J.B.L 315.

[104] Amongst those who adumbrate this view is A.D.M. Forte, "*Unfair Contract Terms: Evaluating an EEC Perspective*", [1985] L.M.C.L.Q. 482 at 491 *et seq*. These proponents also commonly contend that the administrative control can avoid the problem of uncertainty posited by the determination of unfairness. This appears too simplistic. As earlier mentioned, the administrative control such as the preventive action does not necessarily preclude the determination of unfairness. The uncertainty problem should, therefore, be tackled by means of appropriate criteria for the assessment of the unfair character of contract terms, the task to be performed by this thesis in the next chapter.

[105] Article 7(2).

to a Member State to design the procedure and substance of this means. In addition, the Directive allows the consequence that a decision reached and appropriate measure accordingly applied by the adjudicatory body in an individual action brought to it by the persons or organisations entrusted by law to protect consumers' legitimate interests may be effective not only against a particular seller or supplier who is alleged to use the unfair terms but also against *other* sellers or suppliers from the same economic sector or their associations which use or recommend those terms. An additionally extensive effect is that such decision and measure can also be directed to *similar* terms.[106] In this respect, the effect of the preventive action suggested by the Directive is, it is submitted, wider than by way of Orders made under the Fair Trading Act 1973.[107]

In the United Kingdom, as the power to initiate a preventive action has already been vested in the Director-General of Fair Trading under the Fair Trading Act 1973, the Regulations implement the Directive by entitling only the holder of this office to initiate the proceedings provided that there is a complaint made to him that any contract term drawn up for general use is unfair.[108] No consumer organisation is permitted to bring an action on behalf of consumers although it can make a complaint to the Director-General of Fair Trading. Indeed, the Regulations do not specify who can make a complaint. It follows, therefore, that any person is allowed to do so. The Director-General is *obliged* to consider any such complaint unless it appears to be frivolous or vexatious. If he considers that the contract term in relation to which the complaint has been made is unfair, he may, *at his own discretion*, apply to the court for an injunction.[109] The court may grant an injunction on such terms as it thinks fit.[110] The

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[106] Article 7(3).

[107] Another wider effect is that under the Fair Trading Act 1973 the Director-General can exercise this power only in relation to a trade practice which is detrimental to the interests of consumers *in the United Kingdom* while the Directive imposes no such restriction, with the result that conduct in the United Kingdom which affects the interests of consumers in other member states can be subject to the exercise of the equivalent power.

[108] Regulation 8(1)

[109] Regulation 8(2).

[110] Regulation 8(5).

application for an injunction is discretionary rather than obligatory because the Director-General may considers it appropriate to seek undertakings by users of unfair terms.[111] The requirement that the Director-General give reasons for his decision to apply or not to apply for an injunction[112] will compel him to exercise due diligence and consideration.

The extensive effects of the preventive action as suggested by the Directive are also implemented. The application by the Director-General for a court injunction can be made against "*any person* appearing to him to be using or recommending use of such a term in contracts concluded with consumers".[113] Likewise, the court injunction may relate not only to the use of a particular contract term but to "*any similar term, or a term having like effect*, used or recommended for use by *any party* to the proceedings".[114]

It is worth mentioning for the sake of completion that the concept of pre-validation was also considered by the House of Lords Select Committee. However, the Committee felt that it was not required by the Directive and that the idea should be re-examined with particular reference to experience elsewhere.[115]

VII. CONCLUSION

The Directive on Unfair Terms in Consumer Contracts has appeared to be a remarkable achievement in the approximation of the laws of contract within the Community in the matter of the protection of consumers against unfair terms in contracts. Indeed, this European legislation has gained support, wholly or in part, from

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[111] Regulation 8(3).

[112] Regulation 8(4).

[113] Regulation 8(2).

[114] Regulation 8(6) (italics added).

[115] See Sixth Report, *op. cit.*, (footnote 17, *supra*), para 86, p. 27. In the academic circle, Duffy argues that pre-validation is compatible with the Directive and is worth adopting: see *op. cit.*, (footnote 33, *supra*).

many legal scholars.[116] Given that it applies to *all* terms in, generally speaking, *all* contracts, the Directive can be regarded as establishing a "general rule" for the control of unfairness in contractual terms. Considered in this light, its recent implementation by the Regulations has, to a considerable extent, filled the inadequacy of the Unfair Contract Terms Act 1977 the application of which is restricted to exclusion clauses. A general rule which is proposed in this thesis has thus now been found its emergence in the United Kingdom.

Despite some inaptness in its framework, the Directive is meritorious in various aspects which are in line with the proposals made in this thesis. First, it does not meddle with substantive unfairness *per se*. Rather, it empowers the courts to nullify a contractual term only when the unfair result of the term has been caused by some unfair procedure. Both procedural and substantive unfairness, that is, must be present for the term to be destructible. This unfair procedure is intended to include the common situation in which the consumer has entered into the contract without fully understanding the implications of complex terms used by traders or without being aware of the existence of inconspicuous terms contained therein. Secondly, no allegation is allowed to be made that the price or remuneration itself is unfair. Furthermore, the protection against unfair terms is not restricted to standard-form contracts although the particular concern is concentrated on this type of agreement. Next, the scenario in which a contract is made as between two private individuals neither of whom is carrying on business is excluded from judicial scrutiny as to unfairness in the terms of such contract. Finally, agreements between commercially sophisticated businessmen also fall outside the ambit of the Directive.

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[116] See, for example, Hondius, *op. cit.*, (footnote 29, *supra*), at 44; Dean, *op. cit.* (footnote 65, *supra*), at 590. F.M.B. Reynolds describes the implementation of the Directive as being "likely to produce a situation of nightmarish complexity in an area...where simple and "user-friendly" rules should be the order of the day". However, this is merely to raise concern with the temporary confusion generated by the new rules overlapping with UCTA rather than to refute the desirability of the framework of the Directive: see "*Unfair Contract Terms*" (Notes), (1994) 110 L.Q.R. 1. Collins, in *op. cit.* (footnote 43, *supra*) at 253, views the Directive as not only concerned with the fairness of the contract between the parties but also capable of fitting into the aspirations of the "social market" which he attempts to implore in his book: *The Law of Contract*, 2nd edn., (Butterworth, 1993). In this regard, he concedes, at 254, that the Directive imposes duties to respect the other's interests during the negotiations as well as to co-operate during performance of the contract. For summarisation of his socialist account of contract law, see footnote 226 in Chapter 1, *supra*.

Nevertheless, shortcomings of the Directive's paternalistic framework can be seen in the following facts in respect of which this thesis proposes the reform. First, coalescing factors determinative of unfair procedure (i.e. procedural unfairness) under the "good faith" locution leads to two undesirable results. It misdescribes the use by traders of prolix and convoluted terms which are unintelligible to laypersons as "bad faith". More importantly, the instance in which a contracting party has acceded to an unfair term as a result of transaction haste although the term is well eye-catching and expressed in intelligible language is excluded from the protective teeth of the Directive as long as "bad faith" is inconceivable in the speedy nature of the transaction alone. This under-protective feature appears in the face of the omnipresence of alacrity in the modern world of commerce.

Secondly, the recognition by the Directive of monopoly as procedural unfairness which may give rise to judicial inspection of the substance of a contract term is unnecessarily over-protective for the reasons adumbrated in Chapter 1. It should be added that this approach tends to result in vexatious litigation as well. Fortunately, this possible vexation is alleviated by the praiseworthy provision that "price terms" cannot be regarded as unfair. Another over-protective character is found in the Directive's applicability to oral contracts. On the other hand, the Directive is under-protective when it prevents small or unsophisticated businessmen from litigating unfair terms in the contracts they have made with the sophisticated class of traders when their business is in the form to which the law ascribes the separate corporate personality or when the transaction in question forms an integral part of their business.

Reform of the law which has the effect of establishing a general rule for the control of unfair terms in contracts will be the subject of discussion in the final chapter of this thesis. Suffice it to say here that the correction of undesirable features of the Directive by domestic law may face the restriction stemming from the member state's obligation, as required by the Treaty, to observe the provisions of the Directive. Correction is not problematic in respect of the under-protective characters of the Directive since, as earlier mentioned, the Directive itself lays down merely a minimum degree of protection and permits a member state to impose a higher level of protection through more stringent domestic provisions. The problem, thus, lies in those over-

protective features in the framework of the Directive. Certainly, domestic rectification by reducing the undesirable scope of protection will result in the United Kingdom's breach of her international commitment. Amendments must, therefore, be made at the Community level itself.

CHAPTER 6

CRITERIA FOR ASSESSING UNFAIR CHARACTERS OF UNFAIR TERMS

I: INTRODUCTION

This thesis has so far demonstrated the desirability and necessity of special legislation which has the effect of allowing judicial review of fairness of contract terms generally. It has also been pointed out that the unfair content of a particular contract term must be proved to have resulted from some procedural unfairness before the court can strike down the term in favour of the aggrieved party. We have clearly delineated the procedural echelon of unfairness and suggested that it is the ignorance of the existence or implications of contract terms that forms the sound and justifiable basis for a court's further inquiry into fairness in the substance of the term concerned. Without much difficulty, an analysis of this thesis has revealed that three ignorance-based allegations should be permissible: inconspicuousness, lack of opportunity to obtain the knowledge of the contents of contract terms and inability to understand complex terms. The difficulty which arises from this approach of contractual review lies, rather, in the "substantive unfairness" echelon. Objections to the notion of subjecting a contract term to judicial scrutiny over fairness have been much leveled at the paucity of clear and determinable criteria for assessing an unfair character of unfairness in the substantive dimension. It is often argued that such a notion will result in an insurmountable degree of uncertainty and unpredictability. The industry's incentives, this argument goes, may be at stake when traders are unable to ascertain at the outset whether the terms inserted in their contracts with their customers will be struck down or upheld by the courts. In an endeavour to obviate this problem, it is thus the task of this Chapter to work out sharp and appropriate yardsticks of substantive unfairness of terms used in individual agreements.

II. UNCERTAINTY AND UNPREDICTABILITY RE-EXAMINED

Certainty and predictability with regard to legal consequences of contractual relations made by parties to an individual agreement is no doubt a matter of great importance in the law of contract. Legal rules must be sufficiently transparent to the

extent which can enable contracting parties to lay out and allocate rights as well as liabilities between them and assure all parties that those rights and liabilities are to be enforced by the courts in the event of breach by either party. A legal rule which is founded upon indeterminable components will result in the parties being unable to predict benefits to be otherwise obtained from the contract. In economic terms, this state of uncertainty and unpredictability prevents individuals' maximisation of utility, the paramount goal which the law of contract strives to achieve.[1] As a result, adverse impacts on consumers and on national economy as a whole are likely to materialise, for most firms are inclined to refrain from engaging in transactions from which pecuniary gains are considerably unknown.

Although *absolute* certainty and predictability is an ideal aim of the law, this level of achievement is, in most cases, more Utopian than real. In particular, in the consideration of such a notion as fairness of terms in a contract, absolutism is far from truism. Indeed, traders may not necessarily expect the absolute clarity of legal rules governing their contracts with customers. Their expectation may generally be reduced to "a certain level" of predictability, the level of certainty with which they can foresee that a particular term *is likely to be*, rather than *must be*, enforced or struck down by the court if it is incorporated into their contract. It is submitted that this level of certainty is sufficient to maintain the viability of trade and business in economy.

Certainly, such a level or degree of certainty and predictability can be attained when legislation provides some workable guidelines or criteria for the determination of unfairness in the substantive result of a contract term. With this type of criterion in mind, a trader can avoid the incorporation of a term which is likely to be declared invalid when a breakdown of a contractual relationship leads to litigation. A firm can envisage that their decision to trade on the basis of such a term will also be based on the assumption of risk of invalidity. Their rational judgment will direct their appropriate choice—abstinence from applying the term in the first place or applying it with the risk of judicial nullification.

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[1] See Chapter 1, *supra*.

Residual uncertainty which is inherent in this level of certainty is an inevitable price to pay for the introduction of such a protective piece of legislation. Indeed, it can be tackled by insurance, whether self-insurance or formal insurance. After all, traders carrying on business in the real world usually already expect some degree of risks. Risks of loss which might arise from this *residual* uncertainty in relation to legal validity of some contract terms are thus not commercially objectionable. Notably, as a matter of empirical experience, it has not been heard in other countries (in particular in the United States) where legislation allowing candid judicial review of contractual terms has been enacted that their economy has collapsed as a result of such a supervisory scheme. Given all this, the uncertainty trepidation should not be overstated and regarded as prevailing over the concept of having special legislation empowering the courts to control over fairness of contract terms agreed to as a result of ignorance of the aggrieved party.

Useful criteria for the assessment of unfair substance of terms used in contracts will be presented in this Chapter. These criteria are obtained from the meticulous analysis of case law as well as various provisions laid down by the legislatures both in England and other jurisdictions which we have actually discussed in previous Chapters. Inasmuch as case law is examined, it must be stated here that although many cases concerned contracts made between businessmen, the approaches taken by the courts with reference to criteria of fairness may also be appropriately applied in the consumer context. Generally, the distinction between businessperson contracts and consumer contracts is merely for the purpose of identifying the "sophistication" of contracting parties, which is, in effect, the determination of the procedural, not substantive, prong of fairness. However, before those criteria are attempted, it will be shown in the next section that there exist, indeed, a number of contractual clauses the unfair substance of which is so self-evident that no specific criterion seems to be needed in order to spell out the respect in which the substantive unfairness lies.

III: SELF-EVIDENT UNFAIR SUBSTANCE

The substance of a term in a contract may appear axiomatically unfair. In as much the same sense as duress to the person can be straightforwardly perceived of as

an evil, a natural sense of justice can immediately explicate that the contents of some contract clauses are too atrocious to deserve legal enforcement. Obviously, where this type of unfairness—what this thesis calls "self-evident unfairness"—is present, the court deciding the case will need no specific criteria against which the term is to be struck down. The unfair character is already self-explanatory and is as much apparent to the court as to traders and consumers. Thus, no material difficulty will be confronted by the court in the process of adjudication and in arriving at the appropriate decision when such a term is the subject of litigation. Indeed, self-evident or axiomatic characters of unfairness can be as much reflected in decided cases as in legislative provisions.

1. Self-Evident Unfairness Gleaned from Case Law

As far as case law is concerned, we have witnessed this in various UCTA cases which have been discussed in Chapter 3. First, a clause which has the effect of obliging a party to perform a particular obligation but at the same time allowing that party to refrain from performance without reasonable cause is, no doubt, illusory and self-evidently unfair. *Smith* v. *Eric S. Bush*[2] can provide a striking illustration. The *essence* of an agreement to carry out a visual inspection of premises is the investigation of apparent defects—mere defects which can easily catch the eyes of a careful inspector. The disclaimer which excludes the inspector's liability for all types of inaccuracy of the inspection report has the manifest effect of permitting the inspector not to conduct a careful inspection, which is an obligation required by the contract itself. People of sound mind will regard the content of this clause as unfair. Indeed, Lord Griffiths said in his judgment: "no one has argued that if the purchaser had employed the surveyor himself it would have been reasonable for the surveyor to exclude liability for negligence."[3]

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[2] [1987] 3 W.L.R. 889 (C.A.), [1990] 1 A.C. 831 (H.L.). The decision of the Court of Appeal, particularly the judgment of Dillon L.J. at 896, seemed to articulate the self-evident unfairness more candidly than the decision of the House of Lords.

[3] [1990] 1 A.C. 831, at 859.

Likewise, a contract of sale of the property inarguably has as its *essence* the passing of full title in that property to the buyer. Thus, a term of the contract which deprives the buyer of the right to annul the contract in the event where the title is defective is repugnant to all senses of justice of mankind. As shown in Chapter 3, a clause which produced this consequence once came to the court in *Walker* v. *Boyle*.[4] By the same token, disclaimers of implied undertakings as to title, merchantability or satisfactory quality or fitness for a particular purpose are unfair in the substantive results. Any test of fairness can principally be meant to be no more than a test of procedural fairness (that is to say, if the disclaimer in question has been knowingly and understandingly agreed to, the substantive unfairness will amount to substantive unfairness *per se*).[5] Thus, unless procedural unconscionability is absent,[6] a term which excludes or limits the seller or supplier's liability for consequential damage resulting from breach of those implied undertakings is likely to be regarded as unfair. This type of disclaimer has been held unconscionable in a massive number of cases in the United States and, indeed, the fact that in determining conscionability of such a clause most courts principally looked at procedural impropriety unyieldingly betokens the judicial perception that the substance of the clause is unfair in itself.[7] However, the judicial direct proclamation that the content of such a disclaimer is naturally objectionable is also found in *A & M Produce Co.* v. *FMC Corp.*[8] in which it appears that the tomato weight-seizing machine bought by the farmer malfunctioned only after two months of

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[4] [1982] 1 All E.R. 634, per Dillon J. at 644.

[5] See, for example, *United Van Lines* v. *Hertz Penske Truck Leasing, Inc.* (1989) 8 UCC Rep Serv 2d 1024..

[6] See, for example, *Veeder* v. *NC Machinery Co.* (1989) 10 UCC Rep Serv. 841, discussed in Chapter 4, *supra*.

[7] See, for example, *Industralease Automated & Scientific Equipment Corp.* v. *R.M.E. Enterprises, Inc.* (1977) 396 N.Y.S.2d. 427 (disclaimer in a lease of an incinerator). It is only in some cases that other criteria have been spelled out, explicitly or implicitly, for the determination of the substantive unconscionability of this type of clause; see, for example, *Construction Associates, Inc.* v. *Fargo Water Equipment Co.* (1989) 10 UCC Rep Serv 2d 821, 446 N.W.2d. 237 (a contract for the sale of a PVC water pipe, discussed *infra*); *Martin* v. *Joseph Harris Co., Inc.* (1985) 767 F.2d. 296 (discussed *infra*).

[8] (1982) 186 Cal. Rptr. 114.

the purchase. The following was expressed by the court in adjudging the disclaimer unconscionable:[9]

> "Since a product's performance forms the fundamental basis for a sales contract [sic], it is *patently* unreasonable to assume that a buyer would purchase a standardized mass-produced product from an industry seller without any enforceable performance standards."

In fact, it has also been found that the industry may attempt to arrive at the exculpatory effect of such a provision by an indirect means or by an application of what is known as "definitional clauses".[10] As epitomised by *Henningsen* v. *Bloomfield Motors, Inc.*,[11] a car manufacturer may stipulate in its contracts of sale with customers that repairs of defects in a car will be undertaken by the manufacturer when the defective part is sent to the manufacturer's factory and the examination discloses to its satisfaction that the part is defective. Obviously, such a retention of the uncontrolled discretion to decide the issue of defectiveness may be calculated to an outright disclaimer as regards the merchantability and fitness of the car. In his delivery of judgment, Francis J. agreed with the court in *Mills* v. *Maxwell Motors Sales Corporation*[12] that it would be "repugnant to every conception of justice to hold that, if the parts thus returned for examination were, in point of fact, so defective as to constitute a breach of warranty, the appellee's [buyer's] right of action could be defeated by the appellant's [manufacturer's] arbitrary refusal to recognize that fact". Notably, the court described this provision as representative of the "illusory character of the security presented by the warranty".[13]

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[9] *Ibid.*, at 125 (italics added).

[10] For description of "definitional clauses, see Chapter 3, *supra*.

[11] (1960) 161 A.2d. 69.

[12] (1920) 181 N.W. 152, 22 A.L.R. 130.

[13] (1960) 161 A.2d. 69, at 79 [12]. It is noted that *Henninsen's case* is of particular interest on the issue of the role of privity of contract between a buyer of a product from a dealer and the manufacturer. The court thought that public policy and demands of social justice compelled the elimination of the requirement of privity between the manufacturer and the consumer buyer. This public policy was prompted by the recognition of the impact of modern marketing conditions and commercial practices, as follows. Although, according to a system of independent dealers, manufactured products are initially sold to dealers who will in turn deal with the buying public ostensibly in their own personal capacity as sellers, the manufacturer knows that dealers will not use the products and that the products will finally be purchased by general consumers. Indeed, the manufacturer importunes large-scale advertising to promote the purchase of the goods from dealers by

Self-evident unfairness has found its further manifestation in a clause which provides that payment for the goods or services must be nonetheless made to the seller or supplier and cannot be withheld or set off against any claim by the buyer even in the case where the seller or supplier fails to deliver or supply the goods or services or otherwise fails to perform the core obligation under the contract. At first sight, this clause might not look manifestly objectionable since the buyer who has made the payment can still recover damages from the guilty seller or supplier on the ground of defective goods or services, non-delivery or non-performance, as the case may be. However, this apparently causes an unfair burden on the part of the innocent buyer. In other words, such a clause brings about a similar consequence to a clause which directly allows the seller or supplier to receive remuneration in return for the obligation which he is at liberty to perform or not to perform without any valid reason. The seller or supplier can "free-ride", so to speak, the amount paid by the buyer until the buyer brings an action in damages against the former and damages are granted.[14] Considered in this light, the unfair effect of such a clause is evidently indisputable. In effect, this type of clause has been seen in *Stewart Gill Ltd.* v. *Horatio Myer & Co. Ltd.*[15], an UCTA case. It should be remembered that this case concerned a clause which provided that the customer, in a contract for the supply and installation of an overhead conveyor system, shall not be entitled to withhold payment of any amount due to the supplier-company by any reason whatsoever. Both Lord Donaldson M.R. and Stuart-Smith L.J.

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members of the public. With this advent of mass marketing, the manufacturer becomes remote from the purchaser and, as a result, the court, citing in particular *Baxter* v. *Ford Motor Co.* (1932) 12 P.2d. 409 at 412, *Jacob E. Decker & Sons, Inc.* v. *Capps* (1942) 164 S.W.2d. 828 at 833, *Patargias* v. *Coca-Cola Bottling Co. of Chocago* (1947) 74 N.E.2d. 162, *Worley* v. *Procter & Gamble Mfg. Co.* (1953) 253 S.W.2d. 532 and *Mannsz* v. *Macwhyte Co.* (1946) 155 F.2d. 445, thought that "it would be unjust to recognize a rule that would permit manufacturers of goods to create a demand for their product.. and then, because there is no privity of contract existing between the consumer and the manufacturer, deny the consumer the right to recover if damages result from the absence of those qualities... ": *ibid.*, at 77-84. The notion of disregarding the requirement of privity of contract in such a trading milieu has now been adopted in the product liability legislation and has been gathering momentum in many jurisdictions. Arguably, rather than expressing that privity of contract is disregarded, it can also be said that this is a *constructive* privity of contract. Indeed, it was said in *Madouros* v. *Kansas City Coca-Cola Bottling Co.* (1936) 90 S.W.2d. 445 at 450: "If privity of contract is required, privity of contract exists in the consciousness and understanding of all right-thinking persons". This treatment is, in some way, central to the issue of fairness in contract.

[14] The similar opinion was, in fact, addressed in the decision in *United States Leasing Corp.* v. *Franklin Plaza Apartments* (1971) 319 N.Y.S.2d. 531 (discussed *infra*).

[15] [1992] 2 All E.R. 257 (C.A.)

were of the same opinion that there was no possible justification for preventing a payment even where the supplier-company did not perform its contractual obligation. In particular, Stuart-Smith described the clause as "a defence based on fraud".[16] By parity of reason, the same analysis applies to such a case where the seller or supplier assigns contractual rights to an assignee or endorsee and inserts in the original contract with the buyer a provision prohibiting the buyer from asserting against the assignee or endorsee any defences (including, normally, set-off, recoupment claims or counterclaims) which the buyer may have against the seller. It should be remembered that this found its occurrence in *Unico* v. *Owen*.[17] It was also seen in *MacDonald* v. *First Interstate Credit Alliance, Inc.*[18] and *United States Leasing Corp.* v. *Franklin Plaza Apartments, Inc.*[19] Indeed, in this last-mentioned case, the court expressly addressed that such a provision would result in an "inadequate" and "illusory" remedy for the buyer for the reason that the buyer would be obligated to pay the assignee the entire debt in full and then seek to recoup loss by resort to a cause of action against the original seller. The court further explained that if the buyer should ultimately establish cause of action against the seller and collect a judgment against the latter, "the period of time would have intervened between payment of the assignee's claim and collection of the judgment", rendering it prejudicial since the buyer in the interim does not have the use of the goods or services under the contract.[20]

In fact, a close analysis of many cases above reveals that it is the diversion of the "essence" of a contract that creates the self-evident unfairness in the substantive outcome of its clause. In *Hydraform Products Corp.* v. *American Steel*,[21] it was clear

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[16] See Chapter 3, *supra* at p. 191.

[17] (1967) 232 A.2d. 405.

[18] (1989) 10 UCC Rep Serv 2d 1057, at 1062. See also p. 311 *infra* for the discussion of this case on another issue.

[19] (1971) 319 N.Y.S.2d. 531.

[20] *Ibid.*, at 536. The buyer and the assignee in this case were named the "lessee" and the "lessor" respectively, with the seller being named as the "supplier" since the genuine seller intended to conceal the real nature of the sale (as well as the pertaining assignment) between it and the buyer by falsely framing this sale agreement in the form of a lease between the assignee and the buyer: see p. 313, *infra* for fuller explanation.

[21] (1985) 498 A.2d. 339.

from the history of the transaction that the buyer intended to obtain the steel for manufacturing stoves during the peak season of sales of this product.[22] Apparently, time of delivery was of essence since late shipments would ruin the seasonal manufacturing business. Notwithstanding this background, the contract contained a provision which limited the buyer's remedies to the replacement or refund of the purchase price for defective goods and excluded the seller's liability for all damages arising from breach. Certainly, this provision had the effect of exculpating the seller from liability for late deliveries as well. It was obviously at variance with the essential obligation intended by the contract and was thus evidently unfair. Indeed, it was also noted by the court that if this clause were to be upheld, even the "replacement" remedy could fail of its essential purpose, for the seller could delay the required replacement without being liable to the buyer, thereby leaving the buyer without any effective remedy.[23] The similar consideration is found in *Steele* v. *J. I. Case Co.*[24] A wheat and barley plaintiff-farmer purchased from the defendant three combines to be urgently used for harvesting grain. The provision in the contract merely provided for a correction of deficiencies in the equipment and limited the defendant's liability for any breach (including, of course, breach of the express warranty of prompt correction of the product deficiencies) to returning the purchase price of the product. In a suit to recover damages for the loss caused to the plaintiff's crop by the delay incidental to the defendant's numerous attempts to correct the faults in the combines purchased,[25] the court held this limitation clause unconscionable. One of the crucial facts which obviously compelled the court's finding of substantive unconscionability in this case was that the defendant knew of the urgency and the special needs of the plaintiff. That is, when the essence of the contract was the obtaining of the equipment for such urgent

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[22] *Ibid.*, at 341.

[23] *Ibid.*, at 344, 345.

[24] (1966) 419 P.2d. 902.

[25] No issue arose in this case as to the breach of an implied warranty of merchantability and the exclusion of liability for this breach.

use, it was unfair for the manufacturer to be dilatory in making amends by timely repair.[26]

A contract term which commits one party to perform some obligation (either by doing something or refraining from doing something or the combination of both) in favour of the other party whereas that other party has no contractual commitment to do anything in favour of the former is also another form, indeed a striking form, of self-evident unfairness. Based on this analysis, a term in a contract between a publishing company and a song composer by which the composer is bound to give the publishing company the exclusive right to publish songs in consideration for royalty to be paid by the company in respect of published songs whereas the latter is at total liberty to publish songs of the former is thus obviously unfair. Apparently, such a term can result in the song writer sacrificing his benefit in return for nothing in value in the case where the publishing company decides to publish none of his songs. Once the contract has been concluded, the publishing company can just put it in a drawer at the expense of the composer. The same analysis applies to a similar contract between a recording company and a singer. Indeed, this occurred in *A Schroeder Music Publishing Co. Ltd.* v. *Macaulay*[27] or *Zang Tumb Tuum Records Ltd.* v. *Holly*[28] which this thesis has earlier discussed in Chapter 1. There, we have argued that the decisions by the House of Lords in the former and by the Court of Appeal in the latter are incorrect since there appeared no procedural unfairness in both instant cases—the song writer and the musician group knew of and fully understood the implications of the terms in question and the fact that the contracts were in standard forms and concluded on a 'take-it-or-leave-it' basis was immaterial. It is, however, submitted that had those contracts been entered into as a result of ignorance of the composer or musician group, the terms could have been regarded as unfair in the substantive results. Also, even though *Macaulay's case* and *Holly's case* were principally based on contracts in restraint of trade, the analysis with regard to the unfair substance of the terms

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[26] See also p. 321 *infra* for the court's consideration of "disastrous effect".

[27] [1974] 3 All E.R. 616.

[28] Unreported case but discussed in John Swan, "*Party Autonomy and Judicial Intervention: The Impact of Fairness in Commercial Contracts*", (1994) 7 J.C.L. 1.

concerned can indeed apply with equal force to contracts in general. On this point, the American case of *Campbell Soup Co.* v. *Wentz*[29] can well indicate that the occurrence of this type of clause is not restricted to contracts in restraint of trade. In effect, this pre-Code case has been much discussed in previous chapters. It must be recalled that the clause in this instant case entitled a soup company, who bought from carrot growers unique carrots to be grown on fifteen acres of their farm, to reject carrots in excess of twelve tons to the acre while it prohibited the seller-farmers from selling in any event the carrots (including those rejected by the company) to anyone else unless the company agreed. The United States Court of Appeals (Third Circuit) regarded the sum total of this provision as "driving too hard a bargain" and "carrying a good joke too far".[30]

In the United States, the courts often regard as unfair a clause that excludes the seller's or supplier's liability for losses caused by his own negligence occurring in the performance of a contract. When this type of clause is at issue, a court's determination of its unconscionability is usually much founded upon factual hearings of factors descriptive of procedural unconscionability, for it is discerned that the substantive content of such a clause is already unfair in itself.[31] The same approach has been taken with regard to an indemnity clause—clause which obliges the innocent party to indemnify the other party for damages incurred as a result of that other's own negligence. Both exculpatory and indemnitory effects may possibly be combined under the same provision, as illustrated by the "hold harmless" clause contained in a lease of a service station in *Weaver* v. *American Oil Company*.[32] This clause not only

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[29] (1948) 172 F.2d 80.

[30] It must be said that our discussion here is merely focused on the unfair character of the term in question. We leave aside the fact that the hardship on the farmers in this case did not stem from this unfair character but from the fact that the carrot market price subsequently rose up to three times the contract price. On this point, we have pointed out in a previous chapter that Court erred in declaring the clause unfair when the unfair result was not caused by the unfair substance of the clause itself: see Chapter 5, p. 271.

[31] See, for example, *Johnson* v. *Mobil Oil Corp.* (1976) 415 F.Supp. 264 (a provision in a service station retail dealer contract excluding an oil company's liability for damages was held unconscionable when the station was destroyed by fire caused by the events following the company's delivery of gasoline.)

[32] (1972) 276 N.E.2d. 144.

exculpated the lessor oil company from its liability for any damage or loss caused by its negligence but also held the lessor harmless by compelling the lessee to indemnify the lessor for liabilities for loss caused to anyone on the premises. Although the results of these decisions are desirable in view of the circumstances of the cases, it is submitted that an exclusion of liability for negligent performance is not necessarily self-evidently unfair. The courts will need other criteria for judging fairness of the substance of this type of contractual provision.

In the instance of arbitration, although the parties should be free to choose their contractual method of resolving disputes and of selecting arbitrators as well as the composition of the arbitral tribunal, it is patently inimical to the substantive justice to allow a party to a contract to act as an arbitrator. A provision which has this effect is thus to be struck down as unfair when the contract has been procedurally tainted. Such a provision prominently came to the court in *Graham* v. *Scissor-Tail, Inc.*[33] in which the union to which a musical group was a member was stated by an arbitration clause in a contract between a promoter and this musical group to arbitrate disputes arising therefrom. The court, agreeing with the framework spelled out in *In Re Cross & Brown Company,*[34] was of the opinion that natural justice demanded that a man "may not be a judge in his own cause."[35] Indeed, the designation of one of the parties to a contract as the arbitrator of disputes thereunder has been described as "illusory" in that, to quote the court's expression, "the party so designated will have an interest in the outcome which, in the view of the law, will render fair and reasoned decision, based on the evidence presented, a virtual impossibility."[36] The court announced further that the same result would follow when the designated arbitrator is not the

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[33] (1981) 623 P.2d. 165.

[34] (1957) 167 N.Y.S.2d. 573 (a clause in an employment contract providing that any dispute under the contract was to be arbitrated before the employer whose decision was to be final). The court in this case, in turn, cited *Lipschutz* v. *Gutwirth* (1952) 106 N.E.2d. 8.

[35] *Ibid.*, at 175.

[36] In effect, the expression "illusory" was employed by the court in *Lipschutz* v. *Gutwirth*, *op. cit.*, (footnote 34, *supra*), at 10 where it was said: "no party to a contract, or someone so identified with the party as to be in fact, even though not in name, the party, can be designated as an arbitrator to decide disputes under it. Apart from outraging public policy, such an agreement is illusory; for while in form it provides for arbitration, in substance it yields the power to an adverse party to decide disputes under the contract."

party himself but one whose interests are so allied with those of the party that he is subject to the same disabilities which prevent the party himself from serving.[37]

2. Self-Evident Unfairness Extracted from Legislative Provisions

Some provisions both of UCTA and the EC Directive on Unfair Terms in Consumer Contracts bring out self-evidently unfair terms. Firstly, in UCTA, the exclusion of liability for death or personal injury is absolutely banned simply because it is patently unfair. That the legislature intended to resort to an absolute prohibition rather than the substantive-procedural scheme with regard to this clause is self-explanatory: it was discerned (albeit somewhat overstated) that no one would at all agree to such a clause so that a complete ban would not undermine private preference of individuals. This exclusion is also included in the list of unfair terms provided by the Directive.[38] As explained in Chapter 5, the Directive does not impose an absolute ban on any contractual terms but, instead, requires procedural unfairness (under the "good faith" device) as a pre-condition for judicial invalidation of an allegedly unfair term. It is submitted, however, that once a disclaimer involving death or personal injury is shown to have been included in the contract as a result of some procedural defect, the disclaimer will be struck down forthwith, for its substance is already perceived of as essentially unfair.[39] Next, it has been seen that section 3 of UCTA is also intended to capture a clause which entitles a party to render no performance, in whole or in part (*where, of course, no valid ground for such non-performance exists*). As demonstrated in Chapter 3, this type of clause, to a large extent, exhibits *in itself* an unfair character in the substantive dimension and the reasonableness test which the Act requires it to satisfy operates, in reality, as the statutory desideratum for the inquiry into procedural

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[37] *Ibid.*, at 177.

[38] Subsection (a).

[39] In effect, the identical concept is incarnated in the United States Uniform Commercial Code. UCC § 2-719(3) which provides that consequential damages may be limited or excluded unless unconscionable states further: "limitation of consequential damages for injury to the person in the case of consumer goods is prima facie unconscionable but limitation of damages where the loss is commercial is not". That disclaimer of liability for personal injury is not treated as prima facie unconscionable in the non-consumer context merely implies that procedural defects are less likely to occur in this scenario.

unfairness such as the aggrieved party's lack of knowledge of the implications of the terms.[40] The similar type of clause is contained in subsection (b) of the Directive's list.

The concept of self-evident unfairness is also scattered in other provisions of UCTA. A close examination reveals that the same analysis as made in the foregoing paragraph applies with equal force to indemnity clauses under section 4 which invalidates such a clause unless it is shown to meet the requirement of reasonableness. In addition, it applies to statutory provisions relating to disclaimers of implied warranty of title, merchantable (satisfactory) quality and fitness for a particular purpose. The fact that UCTA prohibits traders from disclaiming liability for defective title in the goods as well as for breach of the implied warranty of quality and fitness indicates the drafters' perception of these disclaimers as being at variance with the natural conception of justice, particularly as far as consumers are concerned. Where a contract is sought to be enforced against a non-consumer party, UCTA requires that a disclaimer relating to the merchantable quality or fitness for a specified purpose satisfy the reasonableness test under the Act. It is submitted that this requirement, in the main, passes judicial muster as to procedural fairness, for the substantive unfairness of such a disclaimer is already conventionally patent. As a matter of fact, this is also true of the position in the United States. UCC § 2-316 provides that exclusion or modification of the implied warranty of merchantability is permissible provided that the clause concerned satisfies the requirement as to "writing" and "conspicuousness" set forth under this section. This is not inconsistent with the unyielding conception that the substance of this type of disclaimer is self-evidently unfair. Rather, the Code merely strives to ensure that the disclaimer is knowingly and voluntarily agreed to so that the ensuing substantive unconscionability can then be regarded as substantive unconscionability *per se* which is insulated from judicial deletion.

More markedly, a number of self-evidently unfair contractual terms are brought out in the EC Directive's list of unfair terms. We have already alluded to the disclaimer of liability for death or personal injury as well as exclusion (or limitation) involving

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[40] However, apart from their reflection of self-evident unfairness, it will be shown in due course that such a clause can be viewed as depicting some other archetype of unfairness as well—necessity for the protection of legitimate interests.

total or partial non-performance of contractual obligations as embodied in subsections (a) and (b) of the list respectively. Apart from these types of clauses, the list includes the following clauses which are, in substance, apparently unfair: a clause which excludes the consumer's right to set off against the seller's or supplier's claim a debt to the consumer owed by the latter,[41] a clause which permits the seller or supplier to retain the sums paid for services not yet supplied where it is the seller or supplier himself who dissolves the contract,[42] a clause which gives the seller or supplier the right to determine whether the goods or services supplied are in conformity with the contract or which gives him the exclusive right to interpret any term of the contract,[43] a clause which obliges the consumer to fulfil all his obligations where the seller or supplier does not perform his own obligation,[44] and a clause which excludes or hinders the consumer's right to take legal action or exercise any other legal remedy, particularly by requiring the consumer to take disputes exclusively to arbitration not covered by legal profession.[45] As seen in our previous discussion of case law, many of these clauses have, in fact, often been invalidated by the courts in England and in the United States even before the Directive came into existence.

III. CRITERIA FOR ASSESSING SUBSTANTIVE UNFAIRNESS

The adventure into courts' decisions as well as provisions enacted by legislatures both in England and elsewhere gives rise to the discovery of several useful criteria for the assessment of unfair substance of terms used in contracts. It is in many cases that the courts deciding on the issue of unfairness or unconscionability have spelled out, whether directly or implicitly, the characteristics of contractual terms which the courts have regarded as unfair or not unfair. Indicia of substantive unfairness can therefore be induced from these judicial adjudications. This can more often be envisioned in the United States than in England, for their statutory unconscionable

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[41] The final part of subsection (b).

[42] The final part of subsection (f).

[43] Subsection (m).

[44] Subsection (o).

[45] Subsection (q).

doctrine which gives the courts a candid power to examine unfairness of contractual terms in general has been in operation long before the parallel rule came into existence in the United Kingdom. Nevertheless, a few criteria have been found in cases decided under UCTA although in most cases most of such criteria have been articulated implicitly rather than expressly. Also of particular interest are provisions in the EC Directive on Unfair Terms in Consumer Contracts. In the foregoing chapter, it has been shown that many criteria for the determination of unfair characters of contract terms have been found in the non-exhaustive list provided by the Directive. These criteria will be discussed in more detail in conjunction with the criteria articulated by the courts in decided cases. Amongst these criteria are necessity for the protection of legitimate interests, disastrous effects, gross disparity, absence of corresponding rights and liabilities, and feasibility of loss avoidance. It will be demonstrated, however, that "reasonable expectation" cannot be self-sustained as an independent criterion of fairness. These will be discussed in turn.

1. Necessity for the Protection of Legitimate Interests

Necessity for the protection of legitimate interests can be taken as a sensible foundation of fairness of a contract term, given that all parties, in making a commercial agreement, will not part with benefits in favour of others without securing their own legitimate interests. A party who employs a term which creates hardship on the other party's side should be allowed to enforce such term against that other if its unfavorable substance is a necessary device to guard his legal interests. Conversely, enforcement should be denied if it appears that those interests can be sufficiently protected by a less severe term or that the term in question is not associated with the protection of relevant interests at all. Indeed, a number of clauses have been struck down by the courts on this basis. As a matter of fact, the consideration of the extent of necessity is also embodied in many enacted provisions, as will be shown below.

1.1. "Necessity for Protection" as Reflected in Case Law

The consideration of the necessity for the protection of legitimate interests has been seen, first, in UCTA cases. The courts have been inclined to hold an exclusion clause reasonable if the circumstances attending the conclusion of the contract

rendered the use of the clause inevitable for the protection of the industry's interests. An instructive illustration can be found in *Singer Co. (U.K.) Ltd.* v. *Tees and Hartlepool Port Authority*.[46] There, the court thought that the fact that numerous cargoes presented to the Port Authority were in practice badly packed or described, coupled with the fact that the Port Authority had no knowledge of the nature or value of the cargoes, made the exclusion and limitation of liability necessary. In addition, the inference can be drawn from the speech of Lord Griffiths in *Smith* v. *Eric S. Bush*[47] that the level of necessity may be determined from the degree of complexity and danger of what has been agreed to be undertaken. For this purpose, it would not be necessary for a firm entrusted to undertake a visual inspection of a property to exclude liability for loss caused by inaccurate statements in a valuation report as long as a visual survey, as opposed to a structural survey, is a simple task which requires no more than an examination of an outer appearance of the property's components.

R. & B. Customs Brokers Co. Ltd. v. *United Dominions Trust Ltd.*[48] is, in fact, another case which revealed the consideration of "necessity for protection" in the judicial reasoning of fairness. However, criticisms need to be addressed with regard to the court's application of this criterion. As mentioned in the previous chapter dealing with UCTA, the sale of the car was consummated on a triangular basis. The party who was named as the seller under that contract was in fact playing the role of a mere financer of the buyer; the original seller being a third party who owned a showroom. The course of dealing was in the following fashion: when an intending buyer wanted to buy a car, the car would be sold by the showroom owner to the financer-seller who would then make a conditional sale agreement with that buyer. The Court of Appeal was of the opinion that the exclusion clause in this setting would be reasonable since the seller in this triangular setting had no practical means of possessing or seeing the goods. It can be argued, however, that when this triangular dealing was the mechanism created as a result of a long-standing relationship between the original seller and the financer-seller, the financer-seller was in a position to compel the original seller to

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[46] [1988] 2 Lloyd's Rep. 164, per Steyn J. at 170.

[47] [1990] 1 A.C. 831 (H.L.).

[48] [1988] 1 W.L.R. 321.

ensure that the goods supplied by the original seller to the intending buyer would be defect-free. On this footing, the financer-seller should be ascribed the same responsibility as the original seller for the goods' non-conformity with the satisfactory quality and fitness. More importantly, the fact that the financer-seller, when held liable to the buyer, could in any event recover damages from the original seller would forcefully compel the conclusion that its interests could already be sufficiently protected without need to exclude its liability to the buyer for the defects of the car. In addition, most potential buyers were unlikely to be aware of the significance of this triangular relationship and would expect that the financer-seller, who was described as the seller in the contract of sale, was the original seller who would be so liable. In sum, the application of the "necessity for the protection of legitimate interests" criterion to the facts in this case should, in reality, have led to a different conclusion in the outcome of the case. This does not, however, mean that this criterion is, in its substance, inappropriate. It was just misapplied in the process of adjudication.

In the United States, a large body of case law under UCC § 2-302 has provided a reflection of the notion that a term which is necessary for the protection of the *proferens*' interests is not unconscionable, and *vice versa*. The famous case of *Williams* v. *Walker-Thomas Furniture Co.*[49] can also be viewed in this light. The facts and the wording of the clause concerned—"add-on clause"—have been explained in Chapter 1. It should be remembered that the clause provided that goods previously purchased from the seller would serve as security for the current purchase. Although the demand of security interest in goods previously purchased was a normally necessary tool for preventing the seller's risk of loss resulting from the greater diminution in value of the goods under the current contract than could sufficiently compensate the seller's loss in the event of the buyer's breach, the security interest in this instant case was granted not only in goods instalment payments of which remained incomplete but also extended to goods which had even been wholly paid off. Apparently, the severity of this clause went beyond the extent of necessity. A similar approach of consideration occurred in *MacDonald* v. *First Interstate Credit Alliance,*

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[49] (1965) 350 F.2d. 445.

Inc.[50] Indeed, the unfair protection in excess of necessity is more radical in this case. There, security agreements made to cover the buyer's purchase of logging equipment contained a "cross-collateralization clause" which, when combined with an "omnibus clause", had the effect of granting the assignee-lender a security interest in *all* property the buyer-debtor owned whether financed by lender or not. The court held that this omnibus clause was enforceable only against equipment which had not had its loan paid off by the buyer-debtor. As the court put it, "it would be unconscionable to read a cross-collateralization provision as allowing a creditor to go back in time to enforce the provision against equipment which is now wholly paid off".[51]

Many decided cases provide further illustrations. In *Gillman* v. *Chase Manhattan Bank*,[52] a clause in a security agreement between Chase Manhattan Bank and a wholesale distributor of tobacco products which was executed by the latter in applying for a letter of credit for the purchase of cigarette stamps provided that the bank could, if it in good faith deemed itself insecure at any time, regard all obligations and liabilities of the applicant to the bank as due and payable forthwith and, as a result, could transfer *without notice and demand* any balance of deposits in the applicant's checking account (i.e. current account) to a separate demand account to which the applicant had no access. When the applicant had repaid part of its debts to a third-party creditor in violation of the subordination agreement, borrowed money from another lender and contravened the "negative pledge" given to the bank, the bank considered itself as insecure and then transferred the funds on deposit in the applicant's checking account to an account entitled "Other Demand Deposits", with the result that no funds remained in the checking account and that checks drawn on it were subsequently dishonoured. The applicant contended that the clause authorising such a transfer of funds was unconscionable. The New York Court of Appeals looked at the specific nature of letters of credit and recognised that the general rule governing letters of credit requires the issuing bank to make payment in favour of the beneficiary who tenders the strictly conforming documentation irrespective of breach or non-

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[50] (1989) 10 UCC Rep Serv 2d 1057.

[51] *Ibid.*, at 1066.

[52] (1988) 7 UCC Rep Serv 2d 945.

performance with regard to the contract between the applicant-buyer and the beneficiary-seller.[53] Based on this uniform rule, the bank's interests will be jeopardised in the event where, for instance, the goods covered by the documents required by the terms of the letter of credit turn out to be seriously defective; in such a case, documents of title (in particular bills of lading) which the bank will then receive from the beneficiary-seller provides no adequate means of protection as long as the value of those defective goods is less than the payment the bank is obligated to made to the beneficiary.[54] Against this background, the Court of Appeals held that the term which gave security interests in bank deposits of the applicant's account was necessary "as a means of protecting the bank from loss due to the financial inability of the account party [the applicant] to make the promised reimbursement".[55]

The decision of the Supreme Court of New Jersey in the leading case of *Unico* v. *Owen*[56] can, in fact, be perceived of as exhibiting the judicial consideration of the magnitude of necessity of a contract clause for the protection of a trader's due interests in dealing with customers. As it may be recalled, the seller in a retail instalment contract for the purchase of stereophonic records albums purported to circumvent the obligation and the executory character of the contract by assigning the contract to a partnership, which had been formed for the purpose of financing conditional sales of consumer goods and which had an intimate relationship with the seller, and inserting a provision to the effect that the buyer could not assert against the assignee any defences (including the defence of failure of consideration in the case where the seller failed to deliver the goods) which the buyer may have had against the original seller. Indeed, the sale contract stipulated that the assignee shall be regarded as

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[53] For details on the absolute obligation of the issuing bank to make payment to a letter of credit's beneficiary independently of any underlying contractual arrangements under the original contract between the seller and buyer, see U.C.P. 500 Articles 3, 6. See also *Benjamin's Sale of Goods*, 4th edn., (Sweet & Maxwell, 1992), paras 23-101.

[54] This legal significance of a bill of lading as a document of title was not discussed by the Court of Appeals in this instant case. However, we attempt to address this to enable fuller understanding of the relationship between the above uniform rule of letters of credit and its vulnerability to issuing banks. For full details on documents of title, see *Benjamin's Sale of Goods*, *ibid.*, paras 18-017, 18-020.

[55]See (1988) 7 UCC Rep Serv 2d 945, at 953.

[56](1967) 232 A.2d. 405.

the seller as well. As noted by the court, the attempt and purpose of the waiver is to give this sale agreement the character of negotiability and to make the assignee-financer a "holder in due course"[57] who would be entitled to recover regardless of the original seller's default. The court considered that the legal basis for granting this immunity to a holder in due course of a negotiable instrument lay in the fact that the history of the original debt in respect of which the instrument was executed in favour of the payee was beyond the knowledge of the assignee or endorsee. But, in the present case, it appears from the totality of the arrangements between the seller and the assignee-financer that this finance partnership exercised extensive control over the seller's entire business operations and had a substantial voice in setting standards for the underlying transaction. On this footing, the financer should, therefore, be considered a participant in the original transaction and not entitled to the "holder in due course" status. [58] In other words, it was implied that the circumstances attending the conclusion of this contract rendered it entirely unnecessary to treat the financer-assignee as holder in due course and allow recovery irrespective of the original seller's breach.[59] In *United States Leasing Corp.* v. *Franklin Plaza Apartments*,[60] the seller who supplied an addressor-printer to a non-profit Housing Corporation seemed to be astute that a clause depriving the buyer of his right to interpose against the assignee a claim arising out of a sale agreement was likely to be declared invalid. The true seller thus sought to circumvent this invalidity by the device of a lease. The facts of this case have, in fact, been recited in Chapter 4 but should be succinctly restated here as follows. Although the negotiations were conducted between this Housing Corporation

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[57] *Ibid.*, at 417.

[58] *Ibid.*, at 417.

[59] *Cf. Star Credit Corporation* v. *Molina* (1969) 298 N.Y.S.2d. 570 in which a provision in a retail instalment contract for the sale of a "food plan" (a freezer and food to keep in it) allowed the seller to assign the contract without notice to the buyer and, at the same time, prohibited the buyer from asserting against an assignee any claim arising out of this sale agreement. Evidence established that the assignment took place on the same day or on the day following the sale. The court was satisfied that the sale contract was, in fact, entered into not primarily to sell this food plan but primarily to obtain commercial paper for assignment to the already selected assignee who had full knowledge of the seller's such intention. However, the court's decision with regard to this provision was based on U.C.C § 9-206 (concerning the right of the assignee who takes the assignment for value and in good faith). The court's consideration of the unconscionability issue was limited to the "price term", which seems incorrect.

[60] (1971) 319 N.Y.S.2d. 531.

and the supplier-seller, the agreement was termed a "lease" which did not name this supplier as a contracting party. Instead, a third company (which was engaged in the business of leasing property and with which the buyer had no prior contact) was named as the "lessor"—a contracting party—while the buyer was named as the "lessee"—the other contracting party—to this lease. The true supplier-seller was described as the "supplier" of the equipment under this lease which provided that any claim by the lessee must be asserted against the supplier and that the lessee must "nevertheless pay Lessor all rents payable under the lease". However, this craftiness did not pass judicial muster when this provision was, in the ultimate result, struck down as unconscionable. In this regard, the court said:[61]

> "From the point of view of the user, it makes little difference that he is labeled a buyer or a lessee. In either case the agreement is unconscionable if the user must pay for something he can't use without the right to assert a meritorious defense or set-off."

In Re Elkins-Dell Manufacturing Company[62] also provides another illustration of judicial recognition of the extent of necessity for the imposition of potentially unfair clauses. The issue of conscionability arose in the proceedings in bankruptcy in this case as the court of bankruptcy found itself empowered by law to inquire into the conscionability of a contract on which a secured creditor's claim was based. The contract in question was the security agreement between the creditor (lender) and the bankrupt (borrower) under which the borrower was required to assign accounts to the lender who would then advance 75% of the value of these assigned accounts to the borrower. However, the lender had the power to refuse to supply funds if they, on their own judgment, found the assigned accounts unacceptable. Despite this sole and unlimited discretion, the provisions of the agreement prohibited the borrower from negotiating for or borrowing money from any other sources as well as from assigning any accounts to any persons or selling or otherwise disposing of its assets. On the date of bankruptcy, substantial advances had been made to the borrower and, also, substantial collections conducted on the accounts assigned but the referee found the contract unconscionable and ordered the lender to turn over the money collected to the

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[61] *Ibid.*, at 535.

[62] (1966) 253 F.Supp. 864.

bankrupt's estate. Finding that the referee ruled the issue of conscionability without thorough factual hearings, the court of bankruptcy remanded the case to the referee on this question but also expressed useful guides for the determination of conscionability. The court said that in a loan to a party in distress or shaky businesses, harsh terms in a security agreement may have been necessary to protect high risk of default and to hold the contract unenforceable would probably be to impose a judicially invented but economically dysfunctional morality upon contracting parties in that it might jeopardise the availability of receivables financing for those who were in need of it.[63] Against this consideration, the court seemed to suggest that the negative pledges above were not unconscionable since they stood as a necessary form of protection against such a high risk of default.[64] Doubt may be cast as to this suggestion. This ruling was sustainable in ordinary negative pledges but might not maintain its merit on the particular facts of the instant case. The negative pledges which accompanied the sole and unlimited discretion on the part of the lender to reject any accounts sought to assign would produce the consequence that the borrower was prohibited from assigning accounts to anyone else and seeking other sources of loan even when the lender did not accept those accounts and then refused to make advances. Such provisions obviously exceeded the extent of necessity for the protection of the lender against the risk of default by the borrower. It is submitted that the discernible reason for holding contractual provisions in this case conscionable should be that as a matter of fact no actual hardship occurred from their unfair substance; it did not appear that the lender exercised the discretion to reject assigned accounts and refuse to make advances. However, had the facts of the case been that the lender rejected the accounts sought to assign and yet claimed that the borrower was in breach when securing a loan from other lenders, the provisions could have been declared unconscionable.

Indeed, the issue of unconscionability which arose in *Campbell Soup Co.* v. *Wentz*[65] can be considered on the same basis. No legitimate interests of the soup

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[63] *Ibid.*, at 871.

[64] *Ibid.*, at 872. The court was also concerned that if these provisions were held unenforceable, lenders would be likely to substitute another form of protection, "perhaps higher interest or more selective choice of borrowers".

[65] (1948) 172 F.2d. 80 (see p. 303 *supra* for the relevant facts of this case).

company could be said to be protected by the clause prohibiting the carrots growers from selling to anyone else such carrots as already *rejected* by the company. Therefore, the clause would normally be regarded as unconscionable. But, since it appeared that the soup company had never exercised the power to reject the farmers' carrots, no hardship stemmed from the unfair substance of the clause and, as a result, the claim of unconscionability should lose its merit.

A "price escalation" clause can also be regarded as a necessary instrument to protect due interests of traders as long as risks of economic fluctuation are likely to exist in the market. The purpose of an escalation clause is to raise a contract price to comport with subsequent changes in the market which render the original price apparently inadequate. Thus, if it is evident that the substance of a price escalation clause goes beyond this purpose in that it is not in any way associated with the adjustment of the price to market fluctuations, the clause can be considered as unfair, as is epitomised by a provision in the contract in *Kerr-McGee Corp.* v. *Northern Utilities, Inc.*[66] which concerned a sale of intrastate natural gas. The clause in this case permitted the seller to raise the contract price to the sum of the price which *any* producer in the area received from the sale of gas. Admittedly, it is normal that traders possess different levels of business skill and thus market the same type of goods at different prices. The fact that other sellers can sell the goods at higher prices than a price required by a contract between one particular seller and buyer has indeed nothing to do with the contract in question.[67] Thus, the escalation clause in this case bore no relation to the business risks,[68] rendering its insertion in the contract unnecessary and unfair.

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[66] (1982) 673 F.2d. 323.

[67] However, in *Kerr-McGee*'s case, the clause was held not unconscionable since no procedural unconscionability was present, especially when the contract was reached between two sophisticated business entities with experienced negotiators representing both parties. Had the clause been employed in a contract between a trader and an unsophisticated consumer, it could not have been upheld.

[68] The expression "relation to the risks" has, in fact, been found in some cases. See, for example, *Re Elkins-Dell Manufacturing Company* (1966) 253 F.Supp. 864 (discussed *supra*), at 873; *Phillips Machinery Co.* v. *LeBlond, Inc.* (1980) 494 F.Supp. 318, at 324 (concerning a clause in a distributorship agreement providing for the absolute right to cancel the contract and excluding consequential damages arising therefrom; however, this provision was held not unconscionable when no recognised procedural unconscionability was shown to have been present at the time the contract

A "submission to jurisdiction" clause is amongst contractual provisions which may exhibit no necessity for the protection of the purveyors' interests. Certainly, both parties to a contract are free to consent in advance to submit their future controversy arising thereunder to any jurisdiction although the court of the chosen jurisdiction may dismiss the action on the ground of *forum non conveniens*. However, in the case where a jurisdictional clause is inserted into the contract without genuine consent of the other party, it may be regarded as an unfair provision if particular facts of the case show that the submission to the specified forum of legal redress is prompted by a motive not in any way connected with the protection against business risks. It is on this foundation that it has been held in *Paragon Homes of New England, Inc.* v. *Langlois*[69] that where residents in Massachusetts hired a corporation in the State of Maine to make improvements to their home, the contract provision which provided that the contract shall be deemed to have been executed in New York and that the parties consented to the jurisdiction of the Supreme Court of New York was "grossly unfair and unconscionable". Indeed, the chosen court noted that the submission to jurisdiction clause was inserted in the contract for the purpose of harassing and embarrassing the home owners in the prosecution or defence of any action.[70] The identical decisions were found in *Paragon Homes of Midwest, Inc.* v. *Crace*[71] and *Paragon Homes, Inc.* v. *Cater*.[72] In both cases, the factual pattern was so repetitious of that presented in the *Langlois*'s case above as to compel the same outcome of adjudication; and in all these cases, the consents of the home owners were unknowingly obtained.[73]

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was made). On analysis, the consideration of the relation to the risks involved is indistinguishable from the "necessity for the protection of legitimate interests".

[69] (1967) 4 UCC Rep Serv 16.

[70] *Ibid.*, at 19.

[71] (1967) 4 UCC Rep Serv 19.

[72] (1968) 288 N.Y.S.2d. 817.

[73] It should also be noted that in these cases the actions were dismissed on the unconscionability ground as an alternative to the *forum non conveniens* ground. As regards the doctrine of *forum non conveniens* of the State of New York, it was explained by the court in the *Langlois*'s case that the consideration was given to the convenience of the courts rather than the litigants: see (1967) 4 UCC Rep Serv 16, at 18.

Our illustrations of fairness or unfairness with reference to the need to protect legitimate interests of contracting parties should also include the following two cases which indeed furnish an instructive contrast between what is really necessary for such a protection and what is not. These are *Kensas Flour Mills Co.* v. *Dirks*[74] on the one hand and *New Prague Flouring Mill Co.* v. *Spears*[75] on the other. Both cases concerned contractual provisions giving one party the option to treat the contract or the time of performance as extended rather than cancelled in the event where the other party was in breach. Inarguably, when one party delays performance or decides not to perform the contract, this breach or repudiation will harm due interests of the other party. Although the loss can be recovered by resort to litigation, in many circumstances litigation may be an unwise avenue. This is normally the case if performance by that party is a crucial factor without which the innocent party will be unable to perform obligations under a chain of contracts he has made, or will make, with third parties. In such a case, the innocent party is most likely to abstain from the cancellation of the contract in question and, instead, persuade the guilty party to perform. A contract clause which allows a party to do so will obviously be necessary for the protection of his due interests. In effect, such position has already been the rule of contract law regarding repudiatory breach. Nevertheless, it will be beyond the limit of necessary protection if the party not in breach is permitted to treat the contract as continued for an *indefinite* period, especially for some motive not relevant to the prevention of loss or business reputation in the sense as explained above. This is indeed what occurred in *New Prague*. A buyer of flour expressly repudiated his obligation to take the goods as well as expressly refused to give shipping directions. By a provision in the contract, the seller was given the right to "extend the shipping date 30 days, and thereafter (as long as buyer's failure or refusal continues) continue the life of the contract by as many successive extensions as seller may desire". In other words, this provision permitted the seller to treat such repudiation as equivalent to a request for an extension of the time for performance for an indefinite succession of 30-day periods until the seller should elect to terminate it. The court held this clause so manifestly unreasonable and

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[74] (1917) 164 P. 272.

[75] (1922) 189 N.W. 815.

seemed to note that the inclusion of this provision was not for the purpose of protecting the seller's interests. It was merely intended to enhance recovery by postponing the date of maturity of the seller's claim for damages from the date on which the period of delivery expired to some time in the indefinite future. That is, the seller, through this device, added to the recovery other damages accruing after the date when the time of delivery matured and the contract was renounced.[76] In contrast, in *Kansas Flour Mills* alluded to above, the option to extend the time of delivery was upheld because the extension was not made for such an indefinite period and such an external purpose as in *New Prague*'s case. Indeed, the court also announced that the option had to be exercised promptly after the default and must be made for a reasonable time.[77]

It should finally be said that the consideration of the necessity for the protection of legitimate interests of the party seeking to enforce an allegedly unfair contractual provision is, in fact, not new to English law. It has long been a normal rule for the determination of reasonableness and validity of clauses in restraint of trade. As mentioned in Chapter 2, the courts' approach to restraint of trade cases is that a restraint in question must be reasonable both with reference to the interests of *the parties* and with reference to the interests of *the public*; and, insofar as the reasonableness as between the parties is concerned, a restraint will be given effect provided that it is not broader than necessary to protect legitimate interests of the party in whose favour the restraint is given. Although it is still controversial whether the "public interest" echelon of reasonableness is needed at all (and full exploration on this issue is outside the scope of this thesis), it is generally agreed that the consideration of reasonableness as between the parties to a restraint is sound and that the "necessity" criterion is appropriate since it is consistent with the general principle of leaving parties to choose their own goals.[78] Seen in this light, it is submitted that this well-founded

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[76] *Ibid.*, at 822, 823. It must be noted that this case is a pre-Code case. In arriving at the adjudication of unfairness, the court thus resorted to the back-door technique: holding that it could not be construed that the indefinite extension was intended by the parties.

[77] (1917) 164 273, at 274.

[78] An interesting recent discussion of the doctrine of restraint of trade is found in Stephen A. Smith, "*Reconstructing Restraint of Trade*", (1996) 15 O.J.L.S. 564. Although most issues raised by Smith's article are beyond this thesis' concern, one point seems to be connected to the framework proposed by

standard of fairness should, in fact, provide a direct avenue for the courts applying it to contracts in general outside the context of restraints of trade. Indeed, we have seen that English courts have occasionally done so without explicit mention of it.

1.2 Legislative Provisions

The description of contractual terms which impose what is unnecessary for the protection of legitimate interests of the enforcing party can also be found in a diversity of provisions enacted by the legislature. We have seen, in the first place, that part of section 13 of UCTA is devoted to describing clauses by which one party imposes inessential burdens on the other party in enforcing rights against the former. Typically, these include the following clauses: a clause which makes the liability subject to restrictive or onerous conditions, a clause which subjects another party to prejudice if such party enforces contractual right or remedy, a clause which excludes or restricts rules of evidence or procedure. Apparently, these clauses are incorporated into a contract principally for the purpose bearing no relevance to the protection of the *proferens*' legitimate interests. This type of clause is also stated in the final part of subsection (q) of the EC Directive: "a clause which has the effect of unduly restricting the evidence available to the consumer or imposing on him a burden of proof which, according to the applicable law, should lie with another party to the contract".

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this thesis. Smith suggests that both procedural and substantive fairness are strictly *irrelevant* to restraint of trade law. At first blush, this may look critically irreconcilable with the account of policing unfairness of contractual terms presented in this thesis. On close analysis, such is not the case. In advocating that procedural fairness is ignored in judicial determination of reasonableness of a restraint of trade, Smith's attention is merely focused on the element of "comparative bargaining power". In the course of his discussion, Smith clarifies that such "cognitive defects" as lack of sophistication or inability to understand the complexity of the agreement are important in assessing the reasonableness of a restraint of trade. Smith expressly asserts that this type of procedural impropriety is a "procedural *defect*", not "procedural *unfairness*": *ibid.*, at 585. However, as we have thoroughly expounded in Chapter 1, this procedural defect can, in reality, be categorised as "procedural unfairness". Considered in this light, Smith's assertion is not inconsistent with this thesis' framework. Now, on the issue of substantive fairness, when Smith concedes that substantive fairness is not a central concern of the restraint of trade law, he merely speaks of substantive fairness in the sense of the "adequacy of consideration", pointing out that a restraint of trade can be held unreasonable even when the covenantor receives a million pounds and that in a few cases in which the courts actually considered the consideration received by the covenantor, the consideration is important not because adequacy of consideration is important but because the consideration constitutes the investment which the covenantee is allowed to protect: *ibid.*, at 589. It can be argued, however, that substantive unfairness can occur not merely in the form of "inadequacy of consideration", and, indeed, in many cases, it is the manner in which rights and liabilities are allocated that forms a substantively unfair result. Thus, seen in this light, the "necessity for the protection" standard can be regarded as a criterion for assessing substantive fairness as well.

As far as the EC Directive is concerned, many other terms enumerated in its non-exclusive list can be grouped under the "necessity for the protection of interests" umbrella. The contents of the following terms are apparently broader than necessary for the protection of the seller's or supplier's legitimate interests: a term which enables the seller or supplier to terminate a contract of indeterminable duration without reasonable notice where there is no serious ground to do so;[79] a term which fixes an unreasonably short deadline for the consumer to express prior to the contract's expiry his desire not to extend the contract and provides that the contract will be automatically extended where the consumer does not indicate otherwise within that deadline;[80] a term which enables the seller or supplier to alter the duration of the contract or any characteristics of the product or service under the contract unilaterally without a valid reason;[81] a term which allows the seller or supplier to transfer his contractual rights and obligations to a third person in a manner which may reduce the guarantees for the consumer.[82]

2. Disastrous Effects on Contractual Parties

This criterion was markedly spelled out in two cases decided under UCTA. First, in *Smith* v. *Eric S. Bush*[83] which was decided by the House of Lords, both Lord Templeman and Lord Griffiths were of the opinion that to allow a firm of surveyors to disclaim liability for loss caused by failure to conduct a careful inspection and valuation of a property would result in a dreadful catastrophe to the intending purchaser of the property (in that the purchaser would lose his home and yet remain obligated to pay off the mortgage) while no such tremendous hardship was likely to be suffered by the firm if loss was to be borne by it.

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[79] Subsection (g).

[80] Subsection (i).

[81] Subsection (j), (k).

[82] Subsection (p).

[83] [1990] 1 A.C. 831 (H.L.).

In effect, an unfairly disastrous effect can often be reflected in a clause which limits the manufacturer's liability for a defective product to a replacement of the goods or the return of the contract price. On many occasions, the damage resulting from a particular defect is far greater than the value of the product sold or supplied. A failure of a herbicide to perform as warranted may, for instance, cause a total or substantial failure of the crop. In such a case, the loss sustained by the farmer will no doubt cover the cost of additional cultivation or the difference in value of the crop which was produced and the value of a normal or average crop for the season in question, while the product might cost a small amount of money. A case like this, indeed, occurred in England in *George Mitchell (Chesterhall) Ltd.* v. *Finney Lock Seeds Ltd.*[84] which concerned the defective and unmerchantable cabbage seeds. Courts in the United States seem to have witnessed this situation more frequently.[85] In some circumstances, the resupply of a like quantity of non-defective product may happen to be totally futile to the aggrieved party. This is illustrated by *Construction Associates, Inc.* v. *Fargo Water Equipment Co.*[86] There, the latent defect in the water pipe purchased by the successful bidder to construct a water supply line for the city of Breckenridge, Minnesota caused leakage which could be repaired only by cutting out the leaking joints on the already completed underground pipeline and fixing it with a stainless steel sleeve. Obviously, the replacement pipe was meaningless in this circumstance.[87]

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[84] [1983] 2 A.C. 803 (H.L.). However, as explained in Chapter 3, there was no procedural fairness in this case and the fact that the House of Lords held the exclusion clause in question to be unfair and unreasonable is subject to criticism. It is submitted that had the buyers been ignorant of its existence or implications, the clause could have been regarded as unfair by reference, *inter alia*, to the "disastrous effect" criterion.

[85] See, for example, *Majors* v. *Kalo Laboratories, Inc.* (1975) 407 F.Supp. 20 (discussed at footnote 121 *infra* with regard to another criterion for unfairness); *Estate of Arena* v. *Abbott & Cobb, Inc.* (1990) 11 UCC Rep Serv 2d 476, 551 N.Y.S.2d. 715; *Herrick* v. *Monsanto Co.* (1989) 9 UCC Rep Serv 2d 828, 874 F.2d. 594; *Martin* v. *Joseph Harris Co., Inc.* (1985) 767 F.2d. 296; *Durham* v. *Ciba-Geigy Corp.* (1982) 33 UCC Rep Serv 588, 315 N.W.2d. 696 (enforcement would leave the farmer "without an adequate remedy"); *Peacock* v. *Ciba-Geigy Corp.* (1980) 8 UCC Rep Serv 2d 688 and *Earl Brace & Sons* v. *Ciba-Geigy Corp.* (1989) 8 UCC Rep Serv 2d 690; *Northrup King Co.* v. *Ammons* (1989) 9 UCC Rep Serv 836 (however, in three last-mentioned cases, the disclaimers of liability for consequential damages were not unconscionable since no procedural unconscionability was present, as to which see Chapter 4, *supra*).

[86] (1989) 10 UCC Rep Serv 2d 821, 446 N.W.2d. 237.

[87] *Cf. Carlson* v. *General Motors Corp.* (1989) 883 F.2d. 287, at 293 where the factors determining "unconscionability" were mentioned to include "the nature of the injuries suffered by the plaintiff".

In this connection, the court's consideration in *Wille* v. *Southwestern Bell Telephone Company*[88] is of particularly intructive value. The unconscionability issue in this case arose as to the clause limiting Bell Telephone Company's liability for errors or omission in yellow page advertisting to an amount equal to the cost of such advertising. An action was brought by an advertiser, an owner of a heating and air conditioning sales and service business, against the company when the one of his business telephone numbers was missing from the yellow pages due to the clerical error in the handling of Wille's request for change in his telephone number after the execution of the advertising contract. In holding that the clause in question was not unconscionable, the court, apart from finding no procedural unconscionability in the formation of the contract, looked at the hardship on the part of the plaintiff in the event of the clause being upheld. In doing so, the court compared this case with *Steele* v. *J. I. Case Co.*,[89] which has been earlier discussed in this Chapter,[90] and noted that while the exclusion or limitation of liability in connection with the deficiencies in the equipment purchased in *Steele*'s case "would cause the farmer to lose everything he had invested in that grain crop", the advertiser in *Wille*'s case "is no worse off by reason of an omission of his ad in the yellow pages than if he had made no contract at all".[91]

3. Gross Disparity

Gross disparity is, obviously, the most striking prototype of unfairness when a contract has been concluded as a result of one party's lack of full understanding of its legal implications. On the one hand, gross disparity may fit in the "self-evident unfairness" category which we have already discussed. On the other hand, however, it can be perceived of as a separate criterion so as to receive more emphasis. Although in a large majority of cases gross disparity in contractual rights and liabilities is difficult to

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[88](1976) 549 P.2d. 903.

[89] (1966) 419 P.2d. 902.

[90] See p. 301, *supra*.

[91] (1976) 549 P.2d. 903, at 908.

be measured from a particular contract term other than price terms[92] (and it is for this reason that other indicia of substantive unfairness are normally required so as to determine clearly whether the term in question is fair or not), some contract clauses can indeed be found as depicting this magnitude of imbalance. Illustrations can be afforded by several cases in the United States.[93] In *Andover Air Limited Partnership* v. *Piper*,[94] the issue of conscionability surrounded a term in a warranty of an aircraft. In addition to the price of the aircraft, the buyer paid an extra amount of over $39,000 to obtain this warranty from the manufacturer. However, the term of the warranty provided that the manufacturer's sole liability, and thus the buyer's sole and exclusive remedy, shall be limited to the repair or replacement of the defective part or component and that the manufacturer's liability for any general, consequential or incidental damages was excluded. Such a warranty term could result in the buyer receiving almost nothing in return for the price paid for it since the cost of a component or spare part could be too nominal in comparison with the damage caused by the defect of the warranted goods. Indeed, in the instant case, the damage to the aircraft which was caused through a crash landing and by a defective landing gear was in excess of $100,000 while the gear-uplock bracket would cost perhaps tens of dollars. It was said by the court that the warranty provided "*very little meaningful protection*"[95] from the manufacturer and it was thus unconscionable.

Objectionably exorbitant disparity was also seen in *Syncsort, Inc.* v. *Indata Services*.[96] Although an action in this case was brought for specific performance, the

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[92] As regards price terms, this thesis has already argued that such a term should not be invalidated on the ground that considerably lower prices are available in the market. Mere ignorance of cheaper sources of supply does not suffice. For a contract price to be regarded as unfair, it must appear that the party who has agreed to that price did not understand the price charged under *that* contract itself. See *American Home Improvement, Inc.* v. *MacIver* (1964) 201 A.2d. 886 in which an agreement for home improvements required the total payment of $2,568 while the value of the goods and services to be received thereunder was only $959 and the homeowners did not understand the statement which set forth the computation of the total charges.

[93] It should be recalled that gross imbalance was the criterion which the draftsmen of the unconscionability section had in mind at the inception of the draft provision: see Chapter 4, *supra*, p. 231.

[94] (1989) 7 UCC Rep Serv 2d 1494.

[95] *Ibid.*, at 1506.

[96] (1988) 7 UCC Rep Serv 2d 642.

court's consideration of fairness can also provide a reflection of the judicial perception of substantive unfairness in general cases. The contract in question, a computer programme licensing contract, required the licensee to pay the licensing fees for full period of three years after its installation in the licensee's office notwithstanding that the contract was duly terminated by the licensee (and the programme together with manuals and magnetic media were returned to the licensor) shortly or after a small fraction of the year. The licensor's application for specific performance was not granted since the court thought that the contract created a disproportionate windfall for the licensor particularly when it appeared that the licensee in this case had in effect used the product only once.[97]

A contract in *Bank of Indiana, National Association* v. *Holyfield*[98] can also illustrate gross disparity. A lease of 115 cows between the lessor-bank and the dairy farmers contained a provision that required the lessees to continue making payments even if the leased cows were destroyed through no fault of the lessees (in this case, 30 cows were killed by a tornado). Of course, it is not necessarily unfair of the seller or supplier to require the buyer to continue payments in the event of the property under the contract being subsequently destroyed by a cause not attributable to the buyer, for the buyer can obtain insurance on the property. Indeed, as far as a lease or a hire-purchase is concerned, it is a common practice that the contract requires the lessee to insure the goods and to be liable for the balance due under the contract. In addition, where the lessor is named the insured on the insurance policy, the lessee's liability will be on the basis that the proceeds from the insurance coverage are to be subtracted from the remaining balance. Such a deal was, in fact, found in *Wilson* v. *World Omni Leasing, Inc.*[99] which concerned a lease of a Toyota pick-up truck that was later demolished in a two-vehicle collision.[100] However, the lease in *Indiana's case* would lead to a different adjudication. In this case, it was the lessor who carried insurance on

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[97] *Ibid.*, at 646.

[98] (1979) 476 F.Supp. 104.

[99] (1989) 8 UCC Rep Serv 2d 628. (1967) 232 A.2d. 405.

[100] The contract in this instant case was not unconscionable also because the lessor had full knowledge and understanding of the terms of the lease, hence no procedural unconscionability.

the cows and obtained the insurance proceeds when the cows were destroyed. Although the lessees were obligated to pay for the insurance premiums, the contract still required full payment of the balance due, without providing for any subtraction of the amount received from the insurer from this balance. The court found the provision which compelled the lessees to continue making monthly payments unconscionable since the entire risk of loss fell on the lessee-farmers.[101] Indeed, the court's expression that the lessor "had nothing more to do than collect the payment" was a colourful description of the gross disparity generated by this lease. *A fortiori* a contract clause which requires payment even if the goods under the contract are not delivered to the buyer exemplifies an offensive imbalance. As we have seen, this occurred in *Unico* v. Owen.[102] The following passage of the judgment is, perhaps, worth a quotation:[103]

> "At this point it need only be said that the design of Universal [the original seller] in adopting this form of contract and presenting it to buyers, not for bargaining purposes but for signature, was to *get the most and give the least*. Overall it includes a multitude of conditions, stipulations, reservations, exceptions and waivers skillfully devised to restrict the liability of the seller within the narrowest limits, and to *leave no avenue of escape from liability on the part of the purchaser*."

4. Absence of Corresponding Right or Obligation

Undeniably, it is a normal consequence of private distribution of contractual benefits that a different set of rights and liabilities fall upon each party. Indeed, in most

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[101] *Ibid.*, at 111. It is noted that the court also pointed out that at the time when the cows were killed the lessor received *tremendous return on its investment*. The total price of 115 cows leased was $70,000 while the total of the lease payments was $125,692.60. It appeared that at the time when 30 cows were destroyed, the lease payments of $41,707.12 had been made to the lessor. In addition, the lessor received $26,106.46 from the proceeds of the subsequent sales of the leased cows which survived but which were rendered incapable of producing milk (as to which see below) and another $15,000 from insurance coverage, thus making a total of $82,812.76 received on the original investment of $70,000.

Another observation is worth a mention here. The court in this case seemed to be much concerned with, to use the court's expression, the "double disaster" faced by the farmers when it appeared that the storm also destroyed the farmers' barn, fences and milking equipment and that, as result of the absence of the equipment, unmilked cows quit producing milk and became so useless as to be sold as beef cattle. It can be argued that the total loss of other things than leased cows was not in any way associated with the provisions of the lease and should be treated as immaterial in the determination of the conscionability of the lease.

[102] (1967) 232 A.2d. 405.

[103] *Ibid.*, at 408 (italics added).

contracts, each party can hardly have identical rights. A right afforded to one party is an obligation to be performed by the other. That said, there exist, however, instances where the *circumstances of the case* demand that if a particular right is given to one party the corresponding or parallel right must also be given to the other in order that the contract can be fair. By the same token, if one party is obligated to perform, the reciprocally corresponding obligation on the part of the other must be required too if fairness is to be observed. Again, this may be in some way homogeneous with the "self-evident unfairness" but it can be regarded as a separate character of unfairness. The concept is also known as the "mirror-image" rule.[104] Although this rule has not been popularised or directly seen in England, the concept has been explicitly applied at least in a few cases involving the contracts between publishers as one side and song-writers or musicians as the other. As exemplified in the well-known case of *A Schroeder Music Publishing Co. Ltd.* v. *Macaulay*,[105] where a song publisher gave a publisher the exclusive right to publish all his songs and the publisher was allowed to terminate the agreement upon notice to the writer, the latter should be given the equivalent right of termination of the contract as well. The peculiar circumstance which compelled the insistence upon granting this corresponding right to the song-writer in this case was that although the publisher was required by the contract to pay royalty to the writer in the event of his songs being subsequently published, the publisher had an absolute discretion to publish them or leave them unpublished. Thus, it was necessary that the writer be entitled to withdraw from this contractual relation so that he would not be made unjustly unemployed at the mercy of the publisher who might not wish to publish his songs at all. [106]

This "mirror-image" notion has been given recognition in the EC Directive. The list of unfair terms thereunder itemises several contract terms which deprive the

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[104] Ewoud Hondius, "*EC Directive on Unfair Terms in Consumer Contracts: Towards a European Law of Contract*", (1994) 7 J.C.L. 34 at 41.

[105] [1974] 3 All E.R. 616.

[106] See also *Clifford Davis Ltd.* v. *WEA Records* [1975] 1 W.L.R. 61; *O'Sullivan* v. *Management Agency* [1985] 3 All E.R. 351 and *Zang Tumb Tuum Records Ltd.* v. *Holly* (unreported but discussed in John Swan, "*Party Autonomy and Judicial Intervention: The Impact of Fairness in Commercial Contracts*", (1994) 7 J.C.L. 1.

consumer of the corresponding right given to the seller or supplier. Firstly, subsection (d) regards a term as unfair if it provides that the seller or supplier can retain money paid by the consumer where the consumer decides not to conclude or perform the contract but without also giving the consumer the right to receive an equivalent amount from the seller or supplier if the latter decides to cancel the contract. Next, the first part of subsection (f) speaks of a term which, to quote its *ipsissima verba*, "authorizes the seller or supplier to dissolve the contract on a discretionary basis where the same facility is not granted to the consumer". Thus, such a situation as in *Macaulay's case* can now be treated under this guidance of the Directive. Moreover, the clauses spelled out by other two subsections—subsection (c) and (o)—can also fit in this "mirror-image" benchmark although they can, on the other hand, also be categorised as self-evident unfairness. Subsection (c) is devoted to a clause which makes an agreement binding on the consumer whereas provision of services is subject to a condition whose realisation depends on his own will alone (that is, it gives the seller or supplier alone the right to perform or not to perform his obligation, in as much the same fashion as in the publisher in *Macaulay's case*) whilst subsection (o) captures a clause which obliges the consumer to fulfil all his obligations where the seller or supplier does not perform his. It is expected that more of contract clauses of this character will become the subject of litigation in the future.

5. Loss-Avoidance Position

The extent to which contracting parties can avoid a particular loss can provide another serviceable measure of fairness of a contract clause sought to circumvent liability for that loss. The party who is in a better position to avoid a loss (in the sense of being able to avoid it more feasibly or cheaply) should not be justified in shifting the risk of that loss to the other party. This criterion exhibits an economic element and, indeed, has been supported by the *Coase Theorem* which has been explained in Chapter 1. Utility can be enhanced, maximised and then reach the state of *efficiency* only when costs are reduced to the minimum. In the real world of no zero costs, legal rules can be an instrument to achieve this economic efficiency—the law should be designed to minimise costs. On this footing, a rule which establishes a criterion of fairness of a contract term by holding that a term is unfair if it transfers the relevant

risk to the party who is in a worse position to guard against it stands as an efficient legal rule, for the requirement that the party who is in a better position to avoid loss bear the risk of that loss will have the effect of curbing excessive costs which will otherwise be expended by the other party.

Certainly, economic efficiency can not prevail over private preference of individuals. Parties to a contract can allocate risks of loss in any fashion whatsoever provided that the contract has been concluded with full knowledge and understanding. In such a case, an apportionment of risks of loss must be given effect regardless of the parties' actual positions in which to avoid the loss. However, where a disputed clause has been agreed to on account of ignorance, it is not objectionable to employ this efficiency as a standard of fairness. It should be remembered that this thesis has deprecated only the *radical version* of economic efficiency—the Posnerian version which has been discussed in Chapter 1. The translation of the economic criterion into a legal rule in such a fashion as advocated above is not an embarkation upon any sense of radicalness.

Generally, two possibilities exist as regards a better position to avoid a particular loss. The first possibility involves the insurance position of contracting parties. In many cases and circumstances, insurance is irrefutably a practical means of risk avoidance. From this point of view, a party who can secure more feasibly or more cheaply an insurance cover for the loss in question presumably stands in a better position to circumvent the loss. Indeed, in the opinions of the courts in several cases, this criterion has been regarded as important although the courts have not extensively articulated the economic relevance of this consideration. In *George Mitchell (Chesterhall) Ltd.* v. *Finney Lock Seeds Ltd.*,[107] the House of Lords found that seedmen could, in the circumstance, insure against the risk of crop failure resulting from the defect in the seeds sold without materially increasing the price of seeds.[108]

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[107] [1983] 2 A.C. 803 (H.L.).

[108] However, it must be said again that the buyers of the seeds in this case were fully aware of the implications of the exclusion clause in question although the term was contained in a standard form. The House of Lords were merely satisfied that the adhesive feature of the contract was a procedural flaw. We have, in Chapter 3, criticised this treatment as incorrect. Notwithstanding, the case reflects the House of Lords' reckoning the parties' insurance positions as central to the determination of fairness of contract terms.

The same consideration appeared in the decision of the Court of Appeal in the case of *Phillips Products Ltd.* v. *Hyland.*[109] It should be remembered that this case concerned a clause in a contract of hire of an excavator and an operator-driver which purported to indirectly exclude the hiring company's vicarious liability for the loss caused by the driver by providing that the driver shall be regarded as an employee of the hirer.[110] The Court of Appeal agreed with the court below that the disclaimer in question was unreasonable, *inter alia*, because any businessman customarily insured against third party claims and did not usually insure against damage caused to his own property by his own employees' negligence. An implication can be drawn from this adjudication that the hiring company was in a better position to avoid the loss by means of insurance and should bear this loss.

Another way in which a party can be said to be in a better position to avoid a particular loss is when that party can better prevent the occurrence of that loss. Particular circumstances of the case may indicate, for instance, that a risk of loss substantially, or even entirely, falls within the control of one party rather than the other. In this situation, it will be unfair of the party who possesses such means of controlling and preventing loss to disclaim liability. Indeed, *Phillips Products Ltd.* v. *Hyland* above provides a striking illustration. Although the hire contract provided that the driver was to be regarded as an employee of the hirer, the hirer could not select the operator-driver and, indeed, totally lacked the knowledge to oversee the way in which the driver used the excavator on the site. This very fact added to the Court of Appeal holding the hiring company's exclusion of liability unreasonable.

The same approach of adjudication has prominently been taken by the courts in the United States. To draw an illustration, it appears in *Henningsen* v. *Bloomfield Motors, Inc.*[111] (which has been earlier discussed) that one of the reasons of particular importance for the court treating an implied warranty of merchantability as necessary and holding the burden of losses consequent upon use of defective articles to be borne

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[109] [1987] 1 W.L.R. 659 (C.A.).

[110] For fuller facts of this case, see Chapter 3, p. 160, *supra.*

[111] (1960) 161 A.2d. 69.

by the manufacturer seemed to be that the manufacturer *alone* was in a position to control the danger when the defects were latent or not readily noticeable to buyers.[112] There, the court said:[113]

> "Under modern conditions the ordinary layman, on responding to the importuning of colorful advertising, has neither the opportunity nor the capacity to inspect or to determine the fitness of an automobile for use; he must rely on the manufacturer who has control of its construction, and to some degree on the dealer who, to the limited extent called for by the manufacturer's instruction, inspects and services it before delivery".[114]

Also, in *Carlson* v. *General Motors*[115] in which buyers of automobiles brought an action against the manufacturer when automobiles turned out to be inherently defective and subject to so frequent breakdowns as to necessitate extensive and expensive repairs, it was claimed, *inter alia*, that the manufacturer's limitations of the operation of the warranties (including the implied warranty of merchantability) to a designated period were unconscionable.[116] The United States Court of Appeals found these "durational limitations" unconscionable. Apart from basing its decision upon relevant facts determinative of procedural unconscionability (of which the court considered "bargaining power", "sophistication", "knowledge and expertise" and an "absence of meaningful choice"), the court's finding of the unconscionability of these limited warranties rested upon the fact that the manufacturer was aware that its product was inherently defective and the buyer had no notice of or ability to detect the problem. The court appeared to assert that to allow disclaimers to stand in these circumstances of the case would be to increase the consequential likelihood of "catastrophic failures".[117] This can also be interpreted as an implication that when the

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[112] *Ibid.*, at 81.

[113] *Ibid.*, at 83.

[114] See also *Worley* v. *Procter & Gamble Mfg. Co.* (1953) 253 S.W.2d. 532, at 537 where it was said: "In the case of food products sold in original packages, and other articles dangerous to life [here a box of soup powder], if defective, the manufacturer, who alone is in a position to inspect and control their preparation, should be held as a warrantor, whether he purveys his products by his own hands, or through a network of independent distributing agencies".

[115] (1989) 883 F.2d. 288.

[116] Another claim concerned the violation of the Magnuson-Moss Warranty Act (U.S.C. §2301-2302. This falls outside the scope of this thesis.

[117] *Ibid.*, at 294.

manufacturer was in a dominant position to prevent the loss from happening, it was unfair to provide for the exclusion of liability for that loss. In economic terms, holding the manufacturer liable in this case would yield an efficient outcome in that the damage to the cars and consequential losses could be prevented or got rid of with less costs by the manufacturer's correction of those known defects.

In *Martin* v. *Joseph Harris Co., Inc.*,[118] the cabbage seed producer disclaimed the implied warranty of merchantability of the seed and limited its liability in any case to the contract price. When it appeared that the seed developed the disease called the black leg, the United States Court of Appeals held this provision unconscionable and gave damages to the buyer-farmers in the sum amounting to the difference in value between the cabbage crops actually raised by the farmers and the crops that would have been raised if the seed had not been diseased. The court's conclusion as to the substantive unconscionability of the clause appears to be prompted by the fact that the presence of the black leg in the seed constituted a latent defect, and was within the control of the producer to prevent. In this regard, the court thought that the farmers were unable to detect this disease until the crop had developed into young plants. The court's recognition of the economic efficiency as a criterion of unconscionability is displayed in the following passage:[119]

> "If Harris Seed [producer] were permitted to rely on the disclaimer and limitation clause to avoid liability under the facts of this case, the farmers who had no notice of, ability to detect, or control over the presence of the black leg could lose their livelihood. On the other hand, Harris Seed which had the knowledge, expertise and means to prevent the disease would only lose a few hundred dollars. Given the unique facts of this case..., we affirmed the district court's finding of unconscionability".[120]

It is unsurpising that a manufacturer's exclusion of liability for damage resulting from *latent* defect in the manufactured product is likely to be struck down as unconscionable.[121] Of course, in some cases the complexity in the production process

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[118] (1985) 767 F.2d. 296.

[119] *Ibid.*, at 301.

[120] Notably, this passage manifests the court's consideration of "disastrous effects" as well.

[121] In *Majors* v. *Kalo Laboratories, Inc.* (1975) 407 F.Supp. 20, a soybean inoculant purchased had a latent defect and the manufacturer knew of the questionable effectiveness of the product, for evidence

may render even the manufacturer to be incapable of preventing the occurrence of this type of defect. However, it may eventually be the manufacturer that stands in a better position to resort to an insurance coverage with regard to losses arising from the defect concerned. After all, the manufacturer's better foresight of consequential damage is likely to create the manufacturer's potential to insure. In contrast, the ignorance of the buyer of the possibility of defect is likely to preclude the buyer securing an insurance cover. If the risk of loss is borne by the latter, it would contribute to unremedial loss, thereby reducing the net wealth of society.

The discussion of loss avoidability as a criterion for assessing fairness cannot be complete without the inclusion of *A & M Produce Co.* v. *FMC Corp.*[122] As shown in the early part of this chapter where "self-evident unfairness" is discussed, this case concerned the disclaimer in a contract for the sale of a tomato weight-sizing machine. Apart from expressing the concept of "patent unreasonableness" (which is squared with the "self-evident unfairness" demonstrated in this thesis), the court expressly deployed the "loss avoidability" consideration in the determination of whether the disclaimer in question was unconscionable. "From a social perspective", the court said, "risk of loss is most appropriately borne by the party best able to prevent its occurrence".[123] The court went on to explain that normally the buyer would rarely be in a better position than the manufacturer-seller to evaluate the performance characteristics of a machine. The court was satisfied by evidence presented in the instant case that A & M, the farmer-buyer, had no previous experience with the machine and was forced to rely on the expertise of FMC, the manufacturer-seller, in recommending the necessary equipment and that, this being so, "FMC was the only

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revealed that the tests conducted by the manufacturer before sales presented grave doubt as to whether the new freeze-drying process which was employed as the method for preserving essential bacteria in a live state was, in fact, an effective process. In holding the manufacturer's limitation of liability to the refund of the price unconscionable, the court was concerned with the fact that the buyer was unable to prevent the loss. Here it was said: "there is no means by which a farmer, with the naked eye and without the assistance of scientific examination not ordinarily available, can discern whether or not Kalo's [manufacturer] freeze-drying process is working or whether or not the product will be effective": *ibid*, at 22.

[122] (1982) 186 Cal. Rptr. 114.

[123] *Ibid.*, at 125 (citing *Escola* v. *Coca Cola Bottling Co.* (1944) 150 P.2d. 436 and *Rodgers* v. *Kemper Construction Co.* (1975) 124 Cal. Rptr. 143.

party reasonably able to prevent this loss by not selling A & M a machine inadequate to meet its expressed needs". These facts compelled the adjudication of unconscionability of the disclaimer with regard to the obvious loss sustained by the farmer-buyer.[124] Indeed, the court agreed with the view advanced by a commentator: "If there is a type of risk allocation that should be subjected to special scrutiny, it is probably the shifting to one party of a risk that *only* the other party can avoid."[125]

6. Reasonable Expectation

"Reasonable expectation" has much been claimed to be a standard of substantive fairness.[126] It has been argued, that is, that a contract term may be regarded as fair in its substance as long as the effect of the term falls within the disadvantaged party's reasonable expectation and, in contrast, will be considered unfair if it produces a consequence different from what that party would reasonably expect to arise from the contract in question. On reflection, this argument may not be as persuasive as it might seem at first blush. It is submitted that "reasonable expectation" is, in reality, more related to procedural unfairness than the substance of contractual provisions. It describes procedural unfairness in the sense that if a term has been knowingly and voluntarily agreed to, it is not contrary to the reasonable expectation of the disadvantaged party and must be given full effect, or, put conversely, if the aggrieved party has accepted the term as a result of the ignorance of its implications, the ensuing unfavourable consequence is not what he has expected.[127] The conclusion which can, at most, be made with reference to the "reasonable expectation" is merely that the consequence (outcome) of the contract or the term concerned is unexpected; but the question as to whether *that unexpected consequence* is fair or not will need to be

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[124] *Ibid.*, at 125-126.

[125] Eddy, "*On the "Essential" Purpose of Limited Remedies: The Metaphysics of UCC Section 2-719(2)*", (1977) 65 Cal. L.R. 28, at 47 (italics in original). See also Stephen A. Smith, "*In Defence of Substantive Fairness*" 112 L.Q.R. 138, at 155 (summarised at footnote 150 of Chapter 1, *supra*).

[126] See the references cited at footnote 78 of Chapter 1, *supra*.

[127] See, for example, *Graham* v. *Scissor-Tail, Inc.* (1981) 623 P.2d. 165, at 172-173 (the promoter's vast experience in the music industry and his acquaintance with the arbitration clause contained in the promotion agreement prepared by the musicians' union resulted in the effect of the clause falling within reasonable expectation of the promoter).

answered by reference to some other criteria external to the party's expectation itself.[128]

Inarguably, "reasonable expectation" has occasionally been mentioned by the courts. However, where it was mentioned, it can simply be understood as descriptive of procedural unfairness in the sense pointed out above, without necessarily being perceived of as suggesting an independent indicator of substantive fairness at all. In this regard, the judgment in *Unico* v. *Owen*[129] can perhaps be cited as an example. In considering the conscionability of the "waiver of defences" clauses, the court thought that no consumer would *expect* to continue payments even when the seller did not deliver the goods required under the contract. Indeed, the court expressed:[130]

> "Of course, it was a bilateral executory contract, and since under the language just quoted "assignee" and "seller" have the same connotation, the reasonable and normal expectation by Owen [the buyer] would be that performance of the delivery obligation was a condition precedent to his undertaking to make installment payments."

Obviously, this expression was mainly intended to draw on the buyer's lack of understanding of the "waivers of defences" in question. Although in the end the court held these waivers unconscionable, we have in fact seen from previous parts of this chapter that their *substantive unconscionability* rested upon some other criteria, not upon the fact that the clauses were not expected by the buyer itself.[131]

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[128] In effect, this view is not unfound in legal scholarship. It has merely received little attention. Indeed, in "*The Limits of Cognition and the Limits of Contracts*" (1995) 47 Stanford L.R. 211 at 247, Professor Eisenberg argues that the rule of U.C.C. § 2-207(1), which refuses to enforce a written contractual term which the party seeking to enforce it knows or should know will violate the reasonable expectations that the other party has formed, rests on a foundation of limited cognition. This argument obviously indicates that "reasonable expectation" is linked with procedural flaw rather than substantive fairness.

[129] (1967) 232 A.2d. 405.

[130] *Ibid.*, at 408.

[131] The only case, so far as this thesis is aware of, in which the court appeared to be under the impression that "reasonable expectation" points to substantive fairness is *Remco Enterprises, Inc.* v. *Houston* (1984) 677 P.2d. 567. There, it was said that the violation of "reasonable expectation" was *one* example of substantive unconscionability. However, no elaboration was made on this point, so that this expression may be regarded as too offhanded to be authoritative.

It is also noted that the court in this case also mentioned "gross disparities *in price*" as another example of substantive unconscionability. We have, in Chapter 4, criticised this as incorrect. In addition, as explained in that chapter, the court also erred in holding that the unconscionability

It should, finally, be noted that section 3(2)(b)(i) of UCTA subjects to the reasonableness test a clause which entitles a party to "render a contractual performance substantially different from that which was reasonably expected of him". It might be argued that this statutory provision reckons "reasonable expectation" as a criterion for assessing substantive fairness. This is, however, an erroneous conclusion. We have already seen in Chapter 3 that the expression of "reasonable expectation" in this section is only intended to capture the use of "definitional clauses" as a device to circumvent the operation of the Act. The section merely describes that such a clause is to be treated as an exclusion clause as well. But the determination as to whether that exclusion clause is substantively fair must definitely be made by reference to a separate indicator.

V: CONCLUSION

The trepidation as to uncertainty or unpredictability arising from judicial invalidation of contractual provisions should not be overstated. Although absolute certainty is impossible to be attained in the instance concerning fairness, some workable criteria for assessing an unfair substance of contract terms can be established to the extent where traders can foresee that a particular clause is *likely to be* denied enforcement. Residual incertitude is an inevitable price to pay for the introduction of this legislative control and can be obviated by means of insurance.

Unfairness in the content of many contract terms is self-explanatory without need to invoke any other elements as standards of fairness. Aside from this self-evident unfairness, what is fair or unfair can appropriately be determined by reference to the "necessity for the protection of legitimate interests" of the party seeking to enforce the term concerned. This standard of fairness has indeed largely been employed by the courts and there is no reason to limit its application to the instance of contracts in restraint of trade. In addition, the balance of "disastrous effects" on the parties to a contract can play an important role in judging fairness of a contract term. Also, even if inadequacy of consideration is immaterial, a contract provision which has the obvious

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doctrine merely requires either procedural unconscionability or substantive unconscionability, not necessarily both.

effect of giving almost nothing in value to the aggrieved party cannot be regarded as fair. Moreover, circumstances of a particular case may render a particular clause to be unfair if a right is given to one party without the corresponding right being also granted to the other. Finally, both economic and moral conceptions of justice support the conclusion that a term which shifts relevant risks of loss to the party who is in a worse position to avoid or prevent that loss is not fair. With regard to "reasonable expectation", it is descriptive of procedural fairness rather than substantive fairness.

Of course, the determination of fairness must be conducted with utmost circumspection. This task requires meticulous consideration of all factors. It may be that more than one criteria have to be applied in conjunction in order to reach the fairest result possible. For instance, in the case of a disclaimer of liability for consequential loss resulting from the failure of herbicides to perform as warranted, such factors as weather conditions, presence of other materials or the manner of use or application may altogether render the elimination of all risks to be impossible, with the result that the disclaimer is necessary for the protection of legitimate interest of the manufacturer. However, when the disastrous effect and avoidability of risk, by insurance or otherwise, are taken into account, it will seem fairer for the risk to be borne or insured against by the manufacturer rather than by farmers. Manufacturers can foresee that such a disclaimer is likely to be struck down by the court if litigation arises. With this degree of certainty, the viability of business and trade can be preserved.

CHAPTER 7

CONCLUSION: SUGGESTION FOR LAW REFORM

Our long journey into English, American and European regimes of controlling unfair terms in contracts has considerably echoed shortcomings as well as appropriate features in the frameworks employed by the legislatures. This leads to the suggestion for the systematic reform of English law in this sphere. Of course, those defects found to have existed need to be rectified while all the apposite characters must be preserved.

As we have seen, the Unfair Contract Terms Act 1977 ("UCTA" or "the Act") has served as a "general rule" for the control of unfair terms in contracts although its application is, generally speaking, *limited* to exclusion clauses. It has been seen that unfair terms can stand in the form other than of exclusion clauses and, consequently, the legislative policing scheme should be extended to contract terms in general. Indeed, the introduction of the *full-scale* "general rule" empowering the courts to scrutinise unfairness can aptly be carried out by restructuring UCTA. Although it is possible to enact a separate act to be applicable side by side with UCTA, this alternative may be an unwise choice in view of unnecessary confusion which will be most likely to emerge from the application of two regimes. Undeniably, good law should reduce confusion to the minimum and, on this basis, closely related matters should be brought under the same act rather than scattered in different pieces of legislation. Moreover, given that UCTA itself is replete with defects in its conceptual framework and needs prompt reform, enacting new legislation as a separate act from UCTA means that the legislature will have to consider two bills rather than one bill. Parliament can save its valuable, and extremely limited, time if one complete bill is presented for consideration.

When the time came for the implementation of the Directive on Unfair Terms in Consumer Contracts ("the Directive"), the decision was finally made by the Department of Trade and Industry to implement it by means of statutory instrument—Regulations on Unfair Terms in Consumer Contracts—alongside UCTA rather than by revising and reshaping UCTA itself. As previously pointed out in Chapter 5, this hurried subordinate legislation was due to the pressure from the implementation deadline fixed by the Directive, for awaiting a new Act of Parliament would have

resulted in the United Kingdom breaching the Treaty obligation to observe the law of the Community. As we have seen, the price of this hurried subordinate law is the confusion caused by the overlapping of these two regimes—UCTA on the one hand and Regulations on the other. Some terms are covered by both UCTA and the Regulations (although frameworks employed therein may not necessarily be identical). Some clauses fall within the ambit of UCTA but outside that of the Regulations, or the reverse. Some contractual provisions totally lie outside the operation of both regimes. However, since the hustled implementation by statutory instrument is a matter of convenience, a full bill on unfair contract terms should be systematically worked out and submitted to Parliament for consideration in order that United Kingdom can have a complete and appropriate statute for the purpose of subjecting terms in contracts in general to judicial review with regard to fairness. For this purpose, it is submitted that the full-scale control should be embodied in UCTA itself. The legislature can simply amend this Act by revising its framework and extending its application to contract terms in general in order to afford such protection as required by the Directive as well. Both exclusion clauses and other clauses should be subjected to the same framework. There is no justification for applying different approaches to the same problem.

As seen from Chapter 5, the framework employed in the Directive is meritorious in many respects. These merits can be directly translated into UCTA. In particular, the Act should make it clear that both procedural and substantive unfairness must have existed for a contract term to be declared ineffective; that is, the substance of a contractual clause can be invalidated by the court only when the clause has been agreed to as a result of procedural flaws. Based on the reasons thoroughly advanced in previous chapters, the Act should precisely specify that it is the ignorance of the existence or implications of the term concerned (be it caused by inconspicuousness of the term, lack of opportunity to ascertain the term or inability to understand the term) that entitles the courts to determine fairness in the contents of that term. In this regard, the use of the expression "good faith" to describe these procedural flaws must be discarded.[1] Also, with regard to inability to understand contract terms, the Act should employ only the objective test of ignorance: allowing the ignorant party to plead his

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[1] See pp. 267-269, *supra*.

lack of comprehension only when it appears that the term in question is unintelligible to people in general as well.[2] The legislature should also state clearly that no contractual term can be nullified on the mere ground that it has been offered on a take-it-or-leave-it basis as such. To prevent the misunderstanding that a contract term can be struck down on this basis, it is suggested that the use of such phrase as "inequality of bargaining power" or "strength of bargaining position" should be avoided.

The restriction of judicial scrutiny to non-individually negotiated terms in the fashion set forth in the Directive should be preserved and implemented by the Act for the reason, as already explained in Chapter 5,[3] that individually negotiated terms will not posit ignorance problems. The statutory definition of "non-individually negotiated term" must, however, be extended to encompass a pre-drafted term over which a non-drafting party is offered an opportunity to argue for change but which he in reality does not understand and is thus practically unable to press for alteration to his satisfaction. Furthermore, the legislature should exclude, or continue to exclude, from the operation of the Act oral contracts and contracts between two private individuals neither of whom carries out business, for any ignorance problem which may arise from these contracts will directly exhibit an element of advantage-taking which should be dealt with by equitable rules in the interest of the prevention of the increasing level of abstraction in judicial reasoning.[4]

In addition, amendment ought to be made to the effect that no contract term can be arraigned as unfair in favour of businessmen. The conception that businessmen can also suffer unfair consequences of terms in their contracts especially when the contracts are in standard forms needs to be forthright eliminated. In this connection, the Directive's notion of affording protection only to consumers should be imported into UCTA. Notwithstanding, the Act should expressly state, supposedly by way of definition, that unsophisticated traders should be treated as consumers so that this class of businessmen is not cast out from the protective net.

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[2]See p. 65, *supra*.

[3] See p. 262, *supra*.

[4] See pp. 62, 63, 166, 242 and 256, *supra*.

With regard to substantive unfairness, the position, as embodied in the Directive, that the price or remuneration in and by itself cannot be challenged as unfair must be observed and effectuated by UCTA. Also, in order to alleviate uncertainty which is likely to stem from the courts' determination of unfairness in the substantive dimension, efficient guidelines must be included in UCTA. The Directive's grey-list of unfair terms must be adopted by the Act. Nevertheless, apart from this list, the legislature should include in the Act general criteria for the assessment of unfair characters of contract terms. For this purpose, it is suggested that criteria which this thesis has analysed can be adopted by the legislature. In particular, the position should be taken that a contract term is unfair if it is not necessary for the protection of the interests of the party in whose favour it is invoked or if that party stands in a better position to avoid the loss sought to be excluded by the term.

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